FEDERAL TRADE COMMISSION DECISIONS

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FINDINGS, OPINIONS, AND ORDERS

JANUARY 1, 1982 TO JUNE 30, 1982

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MEMBERS OF THE FEDERAL TRADE COMMISSION AS OF JUNE 30, 1982

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Took oath of office September 30, 1981

DAVID A. CLANTON, *Commissioner*
Took oath of office August 26, 1976

MICHAEL PERTSCHUK, *Commissioner*
Took oath of office April 21, 1977

PATRICA P. BAILEY, *Commissioner*
Took oath of office October 29, 1979

CAROL M. THOMAS, *Secretary*
Appointed June 20, 1977

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FEDERAL TRADE COMMISSION DECISIONS

Findings, Opinions and Orders

In the Matter of

TOMY CORPORATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3080. Complaint, Jan. 6, 1982—Decision, Jan. 6, 1982

This consent order requires a Carson, California corporation, among other things, to cease, in connection with the advertising, distribution and sale of any doll house, accessory, or other toy product, misrepresenting that any collection of products is a set, unless all the products depicted are available for purchase as a set. The firm is prohibited from misrepresenting the availability of any product; describing two or more toys in any advertisement which cannot be purchased as a set, unless accompanied by a disclosure that such products are sold separately; and failing to distribute a copy of the order to all operating divisions, including any entity engaged in the preparation of respondent's advertising.

Appearances

For the Commission: *Judith P. Wilkenfeld* and *Elaine D. Kolish.*

For the respondent: *Aaron Locker* and *Frederick Locker,* New York City.

Complaint

Pursuant to the provisions of the Federal Trade Commission Act any by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Tomy Corporation, a corporation, hereinafter referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

Paragraph 1. Respondent is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its principal office and place of business located at 901 E. 233rd St., Carson, California.

PAR. 2. Respondent is now, and has been engaged in the manufacture, packaging, advertising, offering for sale, sale and distribution of toys and related products, including a dollhouse, furniture and accessories, to the public and to distributors and retailers for sale to the public.

PAR. 3. In the course and conduct of its business, respondent now causes, and continues to cause its toy products to be packaged, sold, shipped and distributed from its place of business in the State of California or from the state of manufacture to purchasers thereof located in various other States of the United States and in the District of Columbia. Respondent maintains and at all times mentioned herein has maintained, a substantial course of trade in said products in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. In the course and conduct of their aforesaid business, respondent has been and is now, in substantial competition in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, with corporations, firms and individuals engaged in the sale and distribution of their respective toy products.

PAR. 5. In the course and conduct of its said business, respondent has disseminated, and caused the dissemination of certain television advertisements concerning said products in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, which were broadcast by television studios located in various States of the United States, and in the District of Columbia, having sufficient power to carry such broadcasts across state lines, for the purpose of inducing, and which were likely to induce, directly or indirectly, the purchase of said products in or affecting commerce.

PAR. 6. The respondent manufactures and assembles a dollhouse, doll family, furniture and accessories under the label "Smaller Home and Garden Deluxe Set." The Smaller Home and Garden Deluxe Set was advertised nationally. These advertisements implied that the Deluxe Set would be readily available for purchase by consumers at retail stores. In truth and in fact, the Smaller Home and Garden Deluxe Set was not available for purchase in a substantial number of retail stores.

PAR. 7. Typical and illustrative of the respondent's television advertisements for the Smaller Home and Garden Deluxe Set are the statements quoted below. In these advertisements, the exterior of an architecturally modern doll house is shown. The interior of the dollhouse is also shown, room by room. All the rooms shown are furnished. In one representative ad, as the various rooms are displayed, an announcer states:

In the Smaller Home and Garden Deluxe Set, there's a living room that has a toy stereo with tiny make-believe headphones and records, and a cozy bedroom with a roll top desk that rolls. There's also a gourmet kitchen. It's for little decorators with big ideas.

As the exterior of the dollhouse is shown a second announcer concludes the ad, by stating, "Smaller Home and Garden Deluxe Set. All this plus other pieces. You have to put it together. By Tomy."

PAR. 8. Through the use of such advertisements disseminated in various parts of the United States, respondent has represented directly and by implication:

1) That the Smaller Home and Garden Deluxe Set is readily available for purchase by consumers as an actual set which contains the dollhouse and all the furniture and accessories depicted and referenced in the advertisements;

2) That the Smaller Home and Garden dollhouse and furniture and accessories are sold together as depicted and referenced in said advertisements.

PAR. 9. In truth and in fact:

1) The Smaller Home and Garden Deluxe Set is not readily available for purchase by consumers;

2) The Smaller Home and Garden dollhouse as packaged and sold does not contain any of the furniture or accessories depicted or referenced in said advertisements.

Therefore, the advertisements referred to herein are unfair and deceptive.

PAR. 10. The use by respondent of the aforesaid false, misleading and deceptive statements, representations, acts and practices has had, and now has, the capacity and tendency to mislead members of the purchasing public into the mistaken belief that said statements and representations were, and are, true and complete, and into the purchase of substantial quantities of respondent's products by reason of said erroneous and mistaken belief.

PAR. 11. The aforesaid acts and practices of respondent, as herein alleged, were and are all to the prejudice and injury of the public and of respondent's competitors, and constituted and now constitute unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce, in violation of Section 5 of the Federal Trade Commission Act, as amended.

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comment filed thereafter by interested persons pursuant to Section 2.34 of its Rules, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Tomy Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its office and principal place of business located at 901 E. 233rd St., in the City of Carson, State of California.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For purposes of this Order, each of the terms listed below is defined as follows:

1. The term *set* shall mean any collection of products that is available for purchase as a unit by consumers or that may

reasonably be inferred to be available for purchase as a unit by consumers.

2. With regard to television advertising, the term *clearly and conspicuously disclosed* shall mean a disclosure which complies with the following requirements: (a) the disclosure shall be presented simultaneously in both the audio and video portions of the television advertisement; (b) the video portion of the disclosure shall contain letters of sufficient size so that it can be easily seen and read on all television sets, regardless of picture tube size; (c) the video portion of the disclosure shall contain letters of a color or shade that readily contrast with the background, and the background shall consist of only one color or shade; (d) no other sounds, including music, shall occur during the audio portion of the disclosure; (e) the video portion of the disclosure shall appear on the screen for a sufficient duration to enable it to be completely read by the viewer; and (f) the audio and video portions of the disclosure shall immediately follow the specific sales representations to which they relate and shall occur each time the representation is presented during the advertisement; in cases where a disclosure is required, but is not linked to a specific representation, it shall appear in immediate conjunction with the major sales theme of the advertisement. In wording the disclosure the audience to whom the disclosure is directed shall be considered in order to assure that viewers (such as children) can understand the full meaning of the disclosure.

I.

It is ordered, That respondent Tomy Corporation, a corporation, its successors and assigns, and respondent's officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of any dollhouse, furniture, accessories or other toy products in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, do forthwith cease and desist from directly or by implication:

A) Representing, in any manner, that any collection of products is a set, if any product in the collection is not included in a set available for purchase by consumers;

B) Depicting or describing in any advertisement, or other printed material disseminated to consumers, two or more non-identical products which are not available for purchase by consumers as a set, unless respondent clearly and conspicuously discloses that the products must be purchased separately;

C) Representing, in any manner, that a product or set is generally or widely available for purchase by consumers in any market area, if the product or set is not substantially available in that market area; *provided, however,* in those instances in which the product or set is not substantially available in that market area, respondent shall be permitted to advertise that the product is available on a limited basis, if the advertisement clearly and conspicuously discloses that the product or set is only available on a limited basis.

II.

It is further ordered, That respondent shall maintain written records and retain:

A) All materials that were relied upon or utilized in making any representation in advertisements, sales materials, promotional materials or post-purchase materials concerning the availability of any dollhouse, furniture and accessories or other toy product;

B) All material relating to the distribution of advertisements, sales materials, promotional materials or post-purchase materials for the above named products;

C) All material relating to the distribution of the above named products.

Such records and materials shall be retained by respondent for a period of at least three years from the date such advertising, sales materials, promotional materials, or post-purchase materials are last disseminated. Such records may be inspected by staff of the Commission upon reasonable notice.

III.

It is further ordered, That respondent shall forthwith distribute a copy of this Order to each of its operating divisions and to any consultant or agency which engages or shall engage in the preparation or dissemination of respondent's advertising.

IV.

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change in the respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this Order.

V.

It is further ordered, That respondent shall, within sixty (60) days after service upon it of this Order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this Order.

IN THE MATTER OF

KELLOGG COMPANY, ET AL.

DISMISSAL ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 8883. Complaint, April 26, 1972—Dismissal Order, Jan. 15, 1982

This order vacates in its entirety, the September 1, 1981 Initial Decision and dismisses with prejudice the Commission's April 26, 1972 complaint which charged three cereal manufacturers with engaging in practices having the effect of maintaining a highly concentrated noncompetitive market structure in the production and sale of ready-to-eat cereals.

Appearances

For the Commission: *Anthony Low Joseph, David M. Malone, Lawrence B. Berman, Claudia R. Higgins, Louis R. Monacell, Alan J. Friedman* and *Dennis F. Johnson.*

For the respondents: *Frederick P. Furth, Thomas R. Fahrner, Bruce J. Wecker, Charles P. Wolff, Michael P. Lehmann* and *George F. Bishop, Furth, Fahrner, Bluemle & Mason,* San Francisco, Calif. and *Scott R. Campbell,* Battle Creek, Mich., in-house counsel, for respondent Kellogg Company. *David C. Murchinson, Edward F. Howrey, Ralph J. Savarese, John R. Fornaciari, Margaret M. Zwisler* and *Frank P. Spinella, Howrey & Simon,* Washington, D.C. and *Clifford L. Whitehill, Robert J. Fulgency* and *John F. Finn,* Minneapolis, Minn., in-house counsel, for respondent General Mills. *Robert MacCrate, James E. Akers, Jeffrey I. Zuckerman, Richard J. Rawson* and *David Lesser, Sullivan & Cromwell,* Washington, D.C., *John F. Kovin, Clifford & Warnke,* Washington, D.C. and *Robert Y. Fox, Peter J. Deluca* and *Bruce L. Bozeman,* White Plains, N.Y., in-house counsel, for respondent General Foods Corporation. *Charles Orlove* and *Joseph M. Jacobs, Jacobs, Burns, Sugarman & Orlove,* Chicago, Ill., for intervenor American Federation of Grain Millers, AFL/CIO.

COMPLAINT

The Federal Trade Commission has reason to believe that the party respondents named in the caption hereof, and hereinafter more particularly designated and described, have violated and are now violating the provisions of Section 5 of the Federal Trade Commission Act (Title 15, U.S.C. 45). Accordingly, the Commission

hereby issues this Complaint stating its charges with respect thereto as follows:

1. Respondents have been and are now engaged in, among other business activities, the manufacture and sale of ready-to-eat (RTE) cereals. RTE cereals are food products made from barley, corn, oats, rice or wheat and various combinations of such grains which are flaked, granulated, puffed, shredded or processed in other ways. RTE cereals are eaten primarily as a breakfast food requiring no cooking or heating preparation by the consumer. **[2]**

All of the respondents have been engaged in the cereal business for over 40 years, and in the RTE cereal business for over 30 years. Since 1950 respondents have consistently accounted for over 84 percent of the sales of RTE cereals.

2. A. Respondent Kellogg Company (Kellogg) was founded in 1906. It is a corporation organized and doing business under the laws of the State of Delaware, with its principal office and place of business located at 235 Porter St., Battle Creek, Michigan. Kellogg manufactures and sells, among other things, RTE cereals, tea, soup, gelatin, and pudding.

In 1970 Kellogg had assets of $347 million and sales of $614 million. In 1970 Kellogg ranked 191st in sales among the nation's 500 largest industrial corporations.

In 1969 Kellogg's domestic sales of RTE cereals were $300 million and advertising expenditures for RTE cereals were over $36 million. Kellogg is the largest producer of RTE cereals in the United States.

B. Respondent General Mills, Inc. (General Mills) was incorporated in 1928. It is a corporation organized and doing business under the laws of the State of Delaware with its principal office and place of business located at 9200 Wayzata Boulevard, Minneapolis, Minnesota. General Mills manufactures and sells, among other things, RTE cereals, flour, toys, chemicals, clothes, and jewelry.

In 1970 General Mills had assets over $665 million, and sales were over $1 billion. In 1970 General Mills ranked 116th in sales among the nation's 500 largest industrial corporations.

In 1970, General Mills' domestic RTE cereal sales amounted to $141 million and advertising expenditures for RTE cereals were $19 million. General Mills is the second largest producer of RTE cereals in the United States. **[3]**

C. Respondent General Foods Corporation (General Foods) was incorporated in 1922. It is a corporation organized and doing business under the laws of the State of Delaware with its principal office and place of business located at 250 North St., White Plains,

New York. As the nation's largest food manufacturer, General Foods produces and sells, among other things, RTE cereals, coffee, beverages, frozen food, pet foods, and desserts.

In 1970 the total assets of General Foods were over $1.3 billion and sales were over $2 billion. In 1970 General Foods ranked 45th in sales among the nation's 500 largest industrial corporations.

In 1970, General Foods' domestic sales of RTE cereals were over $92 million and advertising expenditures for RTE cereals were over $9 million. General Foods is the third largest producer of RTE cereals in the United States.

D. Respondent The Quaker Oats Company (Quaker) was incorporated in 1901. It is a corporation organized and doing business under the laws of the State of New Jersey with its principal office and place of business located at Merchandise Mart Plaza, Chicago, Illinois. Quaker manufacturers and sells, among other things, RTE cereals, frozen food, cookies, pet foods, and chemicals.

In 1970, Quaker had assets over $391 million and sales of $597 million. In 1970 Quaker ranked 195th in sales among the nation's 500 largest industrial corporations.

In 1970 Quaker's domestic sales of RTE cereal were $56 million. Approximately $9 million was spent in 1970 to advertise Quaker RTE cereals. Quaker is the fourth largest producer of RTE cereals in the United States.

E. Nabisco, Inc. (Nabisco) is not a respondent herein. It has, however, participated in some of the acts and practices alleged herein and has contributed by acquiescence to the noncompetitive structure of the RTE cereal market, as alleged herein. Nabisco was incorporated in 1898. It is a corporation organized and doing business under the laws of the State of New Jersey with its principal office and place of business located at 425 Park Ave., New York, New York. Nabisco manufacturers and sells, among other things, RTE cereals, cookies, candy, and snack foods. [4]

In 1970 Nabisco's total assets were over $503 million and sales were over $868 million. In 1970 Nabisco ranked 140th in sales among the nation's 500 largest industrial corporations.

Nabisco's domestic sales of RTE cereals were $26 million in 1969 and advertising expenditures for RTE cereals were $3 million. Nabisco is the fifth largest producer of RTE cereal in the United States.

F. Ralston Purina Company (Ralston) is not a respondent herein. It has, however, participated in some of the acts and practices alleged herein and has contributed by acquiescence to the noncompetitive structure of the RTE cereal market, as alleged herein.

Ralston was incorporated in 1894. It is a corporation organized and doing business under the laws of the State of Missouri with its principal office and place of business located at Checkerboard Square, St. Louis, Missouri. Ralston manufactures and sells, among other things, RTE cereals, pet foods, animal feed, snack foods, and frozen food.

In 1970, Ralston's total assets were over $775 million and sales were over $1.5 billion. In 1970 Ralston ranked 71st in sales among the nation's 500 largest industrial corporations.

In 1969 Ralston's domestic RTE cereal sales were over $20 million and advertising expenditures were over $4 million. Ralston is the sixth largest producer of RTE cereal in the United States.

3. In the course and conduct of their business, respondents now ship, and for some time past have shipped, their RTE cereals from their respective production facilities in various States to locations in various other States of the United States, and maintain and at all times mentioned herein have maintained, a substantial course of trade in RTE cereals in commerce, as "commerce" is defined in the Federal Trade Commission Act.

4. Each of the respondents is in substantial competition with each and all of the other respondents and with other cereal producers in the manufacture and sale of RTE cereals in interstate commerce, except to the extent that competition has been hindered, lessened and eliminated as hereinafter set forth. **[5]**

5. During the past 30 years the RTE cereal industry has experienced substantial growth. In 1940, 453 million pounds of RTE cereal were produced; 900 million pounds were produced in 1960; and in 1970 over 1 billion pounds of RTE cereal were produced. The value of RTE cereal increased from $163 million in 1950 to over $650 million in 1970.

In 1940 respondents' sales accounted for approximately 68 percent of the RTE cereal market; in 1950, for 84 percent, and in 1970, for 90 percent. In 1969 respondents controlled the following approximate shares of the RTE cereal market: Kellogg, 45 percent; General Mills, 21 percent; General Foods, 16 percent; and Quaker, 9 percent. In 1969 Nabisco and Ralston each had an approximate share of four percent of the RTE cereal market.

6. For at least the past 30 years, and continuing to the present, respondents, and each of them, have engaged in acts or have practiced forbearance with respect to the acts of other respondents, the effect of which has been to maintain a highly concentrated, noncompetitive market structure in the production and sale of RTE cereal.

During this period respondents, in maintaining the aforesaid market structure, have been, and are now engaged in, among others, the following acts and practices:

A. *Brand Proliferation, Product Differentiation and Trademark Promotion*

Respondents have introduced to the market a profusion of RTE cereal brands. During the period 1950 through 1970 approximately 150 brands, mostly trademarked, were marketed by respondents. Over half of these brands were introduced after 1960. In introducing and promoting these new brands respondents have employed intensive advertising directed particularly to children. Respondents have used advertising to promote trademarks that conceal the true nature of the product.

Respondents artificially differentiate their RTE cereals. Respondents produce basically similar RTE cereals, and then emphasize and exaggerate trivial variations such as color and shape. Respondents employ trademarks to conceal such basic similarities and to differentiate cereal brands. Respondents also use premiums to induce purchases of RTE cereals. [6]

Respondents have steadily increased the level of advertising expenditures for RTE cereals. During the period 1950 through 1970, respondents' aggregate annual advertising expenditures for RTE cereals tripled from $26 million to $81 million. In 1970, respondents' advertising to sales ratio for RTE cereals averaged 13 percent.

These practices of proliferating brands, differentiating similar products and promoting trademarks through intensive advertising result in high barriers to entry into the RTE cereal market.

B. *Unfair Methods of Competition in Advertising and Product Promotion*

(1) By means of statements and representations contained in their advertisements, respondents:

In advertisements aimed at children, represent directly or by implication, that their RTE cereals without any other foods enable children to perform the physical activities represented or implied in their advertisements.

In truth and in fact:

Respondents' RTE cereals do not enable children to perform the physical activities represented or implied in their advertisements. A

child's ability to perform such physical activities depends on many other factors, including but not limited to general body build, exercise, rest, a balanced diet and age.

(2) By means of statements and representations contained in their advertisements respondents Kellogg, General Mills, and General Foods represent, directly or by implication, that consuming RTE cereal at breakfast:

(a) Will result in loss of body weight without vigorous adherence to a reduced calorie diet,

(b) Will result in maintenance of present body weight even if total caloric intake increases, or

(c) Will result in loss or maintenance of body weight without adherence to regular physical exercise. [7]

In truth and in fact:

(a) Consuming RTE cereal at breakfast will not result in loss of body weight without vigorous adherence to a reduced calorie diet.

(b) Consuming RTE cereal at breakfast will not result in maintenance of body weight even if total caloric intake increases.

(c) Consuming RTE cereal at breakfast will not result in loss or maintenance of body weight without adherence to regular physical exercise.

(3) By means of statements and representations contained in their advertisements respondent General Mills and Kellogg:

(a) Represent, directly or by implication, that failure to eat one of their RTE cereals results in the failure of athletes or others to perform to their full capabilities.

(b) Represent, directly or by implication, that the ingestion of one of their RTE cereals by athletes or others enables them to perform better in their repsective activities.

In truth and in fact:

(a) Failure to eat one of the RTE cereals of such respondents will not result in the failure of athletes or others to perform to their full capabilities.

(b) The ingestion of one of the RTE cereals of such respondents will not enable athletes or others to perform better in their respective activities.

(4) The use of respondents of the aforesaid unfair methods of competition in advertising and product promotion has the capacity and tendency to mislead consumers, particularly children, into the mistaken belief that respondents' RTE cereals are different from

other RTE cereals, thereby facilitating artificial differentiation and brand proliferation. These unfair methods of competition have contributed to and enhanced respondents' [8]ability to obtain and maintain monopoly prices and to exclude competitors from the manufacture and sale of RTE cereal.

C. *Control of Shelf Space*

Kellogg is the principal supplier of shelf space services for the RTE cereal sections of retail grocery outlets. Such services include the selection, placement and removal of RTE cereals and allocation of shelf space for RTE cereals to each respondent and to other RTE cereal producers.

Through such services respondents have interfered with and now interfere with the marketing efforts of other producers of RTE and other breakfast cereals and producers of other breakfast foods. Through such services respondents restrict the shelf positions and the number of facings for Nabisco and Ralston RTE cereals, and remove the RTE cereals of small regional producers.

All respondents acquiesce in and benefit from the Kellogg shelf space program which protects and perpetuates their respective market shares through the removal or controlled exposure of other breakfast food products including, but not limited to, RTE cereal products.

D. *Acquisition of Competitors*

During the past 70 years numerous acquisitions have occurred in the breakfast cereal industry. One of the effects of these acquisitions was the elimination of significant sources of private label RTE cereal. Among them are the following.

In 1943, General Foods acquired Jersey Cereal Company, a Pennsylvania corporation. Before acquisition by General Foods, Jersey Cereal Company was a substantial competitor in the sale of private label and other RTE cereal.

In 1943, Kellogg leased and controlled the manufacturing facilities of Miller Cereal Company, Omaha, Nebraska, a substantial competitor in the sale of private label and other RTE cereal. In 1958, upon termination of the said leasing agreement, Kellogg purchased the assets of Miller. [9]

In 1946, General Foods acquired the RTE manufacturing facilities of Campbell Cereal Company, Minneapolis, Minnesota, a substantial competitor in the sale of RTE cereal. Following this acquisition,

General Foods dismantled the RTE facilities of Campbell and shipped said facilities to South Africa.

The aforesaid acquisitions have enhanced the shared monopoly structure of the RTE cereal industry.

7. Respondents, and each of them, have exercised monopoly power in the RTE cereal market by engaging in the following price and sales promotion practices, among others:

(a) Refrained from challenging each other's decisions to increase prices for RTE cereals, and, in general, acquiesced in or followed the price increases of each of them;

(b) Restricted the use of trade deals and trade-directed promotions for RTE cereals;

(c) Limited the use of consumer-directed promotions for RTE cereals, such as coupons, cents-off deals, and premiums.

8. Respondents' acts and practices aforesaid have had the following effects, among others:

(a) Respondents have, individually and collectively, established and maintained artificially inflated prices for RTE cereals.

(b) Respondents have obtained profits and returns on investment substantially in excess of those that they would have obtained in a competitively structured market.

(c) Product innovation has been largely supplanted by product imitation.

(d) Actual and potential competition in the manufacture and sale of RTE cereals has been hindered, lessened, eliminated and foreclosed. **[10]**

(e) Significant entry in the RTE cereal market has been blockaded for over thirty years.

(f) Meaningful price competition does not exist in the RTE cereal market.

(g) American consumers have been forced to pay substantially higher prices for RTE cereals than they would have had to pay in a competitively structured market.

9. Through the aforesaid acts and practices:

(a) Respondents individually and in combination have maintained, and now maintain, a highly concentrated, noncompetitive market structure in the production and sale of RTE cereal, in violation of Section 5 of the Federal Trade Commission Act.

(b) Respondents, individually and collectively, have obtained,

shared and exercised, and now share and exercise, monopoly power in, and have monopolized, the production and sale of RTE cereal, in violation of Section 5 of the Federal Trade Commission Act.

(c) Respondents, and each of them, have erected, maintained and raised barriers to entry to the RTE cereal market through unfair methods of competition, in violation of Section 5 of the Federal Trade Commission Act.

Initial Decision by

Alvin L. Berman, Administrative Law Judge

September 1, 1981

Preliminary Statement

The Commission's complaint, issued in April 1972, charged Kellogg Company ("Kellogg"), General Mills, Inc. ("General Mills"), General Foods Corporation ("General Foods"), and The Quaker Oats Company ("Quaker") with violating the provisions of Section 5 of the Federal Trade Commission Act (15 U.S.C. 45).

Respondents' violations were alleged to have been in connection with their manufacture and sale of ready-to-eat ("RTE") cereals, described as "food products made from barley, corn, oats, rice or wheat and various combinations of such grains which are flaked, granulated, puffed, shredded or processed in other ways. RTE cereals are eaten primarily as a breakfast food requiring no cooking or heating preparation by the consumer" (Par. 1).

Respondents were charged (Par. 6) with engaging in acts of, or with practicing, "forebearance with respect to the acts of other respondents, the effect of which has been to maintain a highly concentrated, noncompetitive market structure in the production and sale of RTE cereal." The acts and practices charged included brand proliferation, product differentiation and trademark promotion, backed by intensive and steadily increasing levels of advertising (Par. 6A); and control of shelf space to the disadvantage of competitors by acquiescing in a Kellogg shelf space program (Par. 6C). The complaint alleged further, as follows:

7. Respondents, and each of them, have exercised monopoly power in the RTE cereal market by engaging in the following price and sales promotion practices, among others:

(a) Refrained from challenging each other's decisions to increase prices for RTE cereals, and, in general, acquiesced in or followed the price increases of each of them;

(b) Restricted the use of trade deals and trade-directed promotions for RTE cereals;

(c) Limited the use of consumer-directed promotions for RTE cereals, [2]such as coupons, cents-off deals, and premiums.[1]

8. Respondents' acts and practices aforesaid have had the following effects, among others:

(a) Respondents have, individually and collectively, established and maintained artificially inflated prices for RTE cereals.

(b) Respondents have obtained profits and returns on investment substantially in excess of those that they would have obtained in a competitively structured market.

(c) Product innovation has been largely supplanted by product imitation.

(d) Actual and potential competition in the manufacture and sale of RTE cereals has been hindered, lessened, eliminated and foreclosed.

(e) Significant entry in the RTE cereal market has been blockaded for over thirty years.

(f) Meaningful price competition does not exist in the RTE cereal market.

(g) American consumers have been forced to pay substantially higher prices for RTE cereals than they would have had to pay in a competitively structured market.

9. Through the aforesaid acts and practices:

(a) Respondents individually and in combination have maintained, and [3]now maintain, a highly concentrated, noncompetitive market structure in the production and sale of RTE cereal, in violation of Section 5 of the Federal Trade Commission Act.

(b) Respondents, individually and collectively, have obtained, shared and exercised, and now share and exercise, monopoly power in, and have monopolized, the production and sale of RTE cereal, in violation of Section 5 of the Federal Trade Commission Act.

(c) Respondents, and each of them, have erected, maintained and raised barriers to entry to the RTE cereal market through unfair methods of competition, in violation of Section 5 of the Federal Trade Commission Act.

Nabisco, Inc. ("Nabisco") and Ralston Purina Company ("Ralston"), neither of which was named as a respondent, were alleged to have participated in some of the acts and practices alleged in the complaint and, by their acquiescence, to have contributed to the noncompetitive structure of the RTE cereal market (Par. 2E, F).

The complaint further alleged (Pars. 3–4) that the respondents were engaged in commerce in connection with their trade in, and manufacture and sale of, RTE cereals, as "commerce" is defined in the Federal Trade Commission Act.

On June 29, 1972, respondents filed their answers to the complaint in which they admitted engaging in commerce, but otherwise denied, in substance, the allegations of the complaint.

By order of November 16, 1979, the Commission granted the amended motion of the American Federation of Grain Millers AFL–

[1] The complaint also contained certain allegations of false and deceptive advertising (Par. 6B). These allegations are not being pursued by complaint counsel at this time.

CIO/CLC for leave to intervene for the purpose of presenting evidence relative to the relief proposed by complaint counsel.

It is significant that the complaint does not charge respondents with having conspired to monopolize. The words "conspire", "contract" or "agree" (or variants thereof) are nowhere to be found in the complaint. While respondents' acts and practices are alleged (Pars. 8(a), 9(a), (b)), individually and collectively and in combination, to have brought about certain results, no conspiratorial acts or practices are alleged. In light of the "shared monopoly" theory that is being tested by this case and the relative ease of drafting conspiracy charges when it is desired to do so, it can only be concluded that the complaint intentionally did not include the charge of conspiracy. [4]

This reading of the complaint was expressly confirmed by the position taken by complaint counsel early in these proceedings. In Reply Of Complaint Counsel To Motions By General Mills And General Foods For More Definite Statement, filed May 18, 1972, we find, "The complaint is quite clear as to the nature of the collective charge against respondents. *It does not aver conspiracy. It is simply an indictment of shared monopoly and the common course of action pursued by respondents to maintain their monopoly*" (emphasis supplied; at 1–2). This position was affirmed in Opposition Of Complaint Counsel To General Mills' Application For A Determination By The Hearing Examiner That His Ruling Denying Motion For More Definite Statement Involves Reviewable Questions:

> The original motion, which was denied by the Hearing Examiner, dealt with only five areas of the complaint and asked only one question: Should the complaint be read to charge respondents with having conspired or with having engaged in consciously parallel action in violation of Section 5 of the Federal Trade Commission Act? *One part of this question was, in fact, answered clearly and unequivocally by complaint counsel, i.e., conspiracy is not alleged* (emphasis supplied; at 3).

In their Memorandum In Support Of Opposition To General Foods Motion For Severance, dated May 18, 1972, complaint counsel explained that the "complaint charges all four respondents with engaging in certain interdependent acts and practices in order to achieve a highly concentrated, non-competitive market structure and shared monopoly power" (at 1). After noting that competitors are routinely named co-respondents in conspiracy cases, complaint counsel expressly stated, "*Although conspiracy is not alleged in this matter,* the common course of action and the interdependent acts of respondents create a common bond that provides the nexus for joinder in the instant case" (emphasis supplied; at 3). Thus,

complaint counsel were justifying the joinder of respondents in a case that did not charge conspiracy.[2]

In Supplemental Memorandum of Complaint Counsel In Opposition To Severance, filed June 19, 1972, at 4, it was stated, "*Although* [5]*conspiracy is not alleged in this matter* there is a common bond that provides the nexus for joinder in the instant case. . . . The effects of respondents' common practices are actually the same as if they had engaged in a conspiracy" (emphasis supplied). Thus, complaint counsel were clarifying the complaint to the effect that it charged acts and practices to be unlawful because of their anticompetitive effects, but that a charge of conspiracy was not being made.

Complaint counsel confirmed the "no-conspiracy" aspect of the complaint at the very first prehearing conference held on June 5, 1972.

MR. LIEDQUIST:

* * * * * * *

First, there is no mention of conspiracy in the complaint, for that matter we have emphasized this in our reply to respondent's motion.

* * * * * * *

I have already made a statement there is no charge of conspiracy under the complaint. I think this is sufficient. . . .

* * * * * * *

HEARING EXAMINER HINKES: In your words, when you use words "joint", "interdependent", "combination", "collective", "acquiesce", your use of those words or any other words that are used in the complaint, there is no suggestion of conspiracy in the complaint, is that correct?

MR. LIEDQUIST: There is no conspiracy as you would normally plead it in an Anti-Trust matter under the Sherman Act or the FTC.

* * * * * * *

HEARING EXAMINER HINKES: Are you saying that when you used the words of "joint" and "combination", it was joint without a conspiracy, and a combination without a conspiracy. [6]

MR. LIEDQUIST: That is right, Your Honor, and I am saying that they did not meet together (Tr. 17, 25–26, 29).[3] [7]

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[2] This position was affirmed in complaint counsel's Reply To The Quaker Oats Company's Motion For Severance, filed June 19, 1972.

[3] Tr. is an abbreviation for Transcript of Proceeding, and is followed by the page number(s). Other abbreviations used herein include the following:

CP – Complaint Counsel's Proposed Findings of Fact, Conclusions of Law, Order, and Supporting Argument

CPF – Complaint Counsel's Proposed Finding in CP, followed by its number(s)

(Continued)

The position that conspiracy was not alleged was reaffirmed at Tr. 70–71. [8]

On August 10, 1972, Mr. Liedquist reaffirmed and restated complaint counsel's position, in part, as follows:

I said there is no conspiracy. I believe my words also pointed out that there is no conspiracy in the traditional sense of the word. We don't look upon it as generally

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KP – Kellogg's Proposed Findings of Fact
KPF – Kellogg's Proposed Finding in KP, followed by its number(s)
KPL – Kellogg's Proposed Conclusions of Law
GMP – General Mills' Proposed Findings of Fact, Conclusions of Law and Order
GMPF – General Mills' Proposed Finding in GMP, followed by its number(s)
GFP – General Foods' Proposed Findings of Fact, Conclusions of Law, Memorandum and Order
GFPF – General Foods' Proposed Finding in GFP, followed by its number(s)
IP – Intervenor's Proposed Findings of Fact, Conclusions of Law, and Supporting Argument
IPF – Intervenor's Proposed Finding in IP, followed by its number(s)
CR – Complaint Counsel's Reply
CRPF – Complaint Counsel's Proposed Finding in CR, followed by its number(s)
KS – Kellogg's Surreply
GMS – General Mills' Surreply
GMSPF – General Mills' Proposed Finding in GMS, followed by its number(s)
GFS – General Foods' Surreply
GFSPF – General Foods' Proposed Finding in GFS, followed by its number(s)
IS – Intervenor's Surreply
CX – Commission Exhibit
CX–K – Commission Exhibit Secured From Kellogg
CX–GF – Commission Exhibit Secured From General Foods
CX–GM – Commission Exhibit Secured From General Mills
CX–Q – Commission Exhibit Secured From Quaker
CX–R – Commission Exhibit Secured From Ralston
CX–N – Commission Exhibit Secured From Nabisco
CX–CI – Commission Exhibit Secured From Cereal Institute
CX–PG – Commission Exhibit Secured From Procter & Gamble
CX–ACN – Commission Exhibit Secured From A.C. Nielson Co.
CX–NCFM – Commission Exhibit Secured From National Commission on Food Marketing
KX – Kellogg Exhibit
GFX – General Foods Exhibit
GMX – General Mills Exhibit
COURTX – Court Exhibit
QX – Quaker Exhibit
AFX – American Federation of Grain Millers Exhibit

Exhibits are referred to by the abbreviations set forth above followed by the appropriate exhibit number(s) and, if applicable, page(s). Exhibit abbreviations are not repeated within string citations, nor are exhibit numbers repeated when more than one page is referred to.

recognized as a conspiracy. They haven't met behind closed doors. At the same time their behavior hasn't been coincidental behavior. There has been a pattern of behavior, a common course of action that has been followed for thirty years and which amounts to a combination in violation of Section 5 (emphasis supplied; Tr. 104).

Notwithstanding the absence of a charge of conspiracy in the complaint and complaint counsel's early concession to this effect, the case was tried under both a conspiracy and a shared monopoly theory. At the very outset of their Introduction And Summary to their proposed findings of fact (CPF 1–3), complaint counsel state, "In the most traditional antitrust sense, the three respondents have tacitly colluded and cooperated to maintain and exercise monopoly power—'power over price' and 'power to exclude' additional competitors." And, at CP 649, complaint counsel begin their legal argument section on conspiracy with a "TACIT CONSPIRACY" tab and the heading, "RESPONDENTS COMBINED AND CONSPIRED TO MONOPOLIZE THE READY-TO-EAT CEREAL INDUSTRY."

However, complaint counsel may not be heard to urge that a tacit conspiracy was not included in their previous disclaimers of conspiracy. A tacit conspiracy is a conspiracy normally pleaded under the Sherman and Federal Trade Commission Acts. It is still a conspiracy and all essential elements of conspiracy must be proved notwithstanding the fact that the conspiracy may be shown by evidence **[9]** other than that of an express overt agreement. *See, e.g., United States* v. *Bausch & Lomb Optical Co.,* 321 U.S. 707, 723 (1944); *American Tobacco Co.* v. *United States,* 328 U.S. 781, 809–10 (1946).

It would serve no purpose to attempt to trace the steps taken by complaint counsel in reversing their original position and construing the complaint to include a charge of conspiracy. Suffice it to say that on February 24, 1974, in an Order Denying Motion Of General Mills, Inc., For Summary Decision Dismissing Complaint, Judge Hinkes, who was then assigned to this matter, ruled, in part, as follows:

Moreover, the complaint does allege that the respondents individually *and in combination* have maintained a noncompetitive market structure and that individually *and collectively* have obtained, shared and exercised monopoly power, although complaint counsel concede that their behavior is "not a conspiracy in the traditional sense."

General Mills contends, however, that these allegations of the complaint amount to no more than conscious parallelism which, as noted earlier, is not recognized as within the meaning of the Sherman Act. General Mills does not address itself to whether or not conscious parallelism is within the meaning of Section 5 of the Federal Trade Commission Act, an Act which has been recognized as going beyond the narrow confines of the Sherman Act. Moreover, General Mills discounts the complaint's clarification expressed by complaint counsel. They explained that respondents engaged in "interdependent actions and decisions" which they defined as "ones taken with the knowledge that the action requires cooperation of each member of a group in

order to minimize competition among the group and maximize the joint profits of the group's members."

General Mills equates this definition of the complaint with merely conscious parallelism. It may, however, be more nearly equated with a tacit conspiracy (emphasis in original; at 5).

On March 12, 1975, in an Order On Complaint Counsel's Motion Re Discovery, Judge Hinkes allowed depositions covering the issue of conspiracy or similar agreement, relying in part on his February 24, 1974 statement, reproduced above. He also stated, "I agree with [10] complaint counsel that the interrelationship among the respondents by whatever name is a relevant issue and therefore appropriate for discovery" (at 5).

Finally, on August 20, 1976, Judge Hinkes, relying on his orders of February 19, 1974 and March 12, 1975, issued an Order Denying Respondent Kellogg's Motion To Preclude Trial Of Complaint Counsel's Conspiracy Claim. Judge Hinkes concluded by stating, "The interrelationship among respondents by whatever name is an issue raised by this complaint and by respondents' answers thereto" (at 2).

Under the shared monopoly charge of the complaint, which relies upon the concentrated structure of the RTE cereal industry and the conduct of the individual respondents allegedly taken in recognition of their resulting mutual interdependence, evidence of respondents' conduct is admissible. Such evidence would not become inadmissible merely because it tended to show an actual conspiracy or agreement, express or tacit.

On the other hand, as I have already ruled, the complaint does not allege a conspiracy; and a violation of Section 5 of the Federal Trade Commission Act by reason of conspiracy is not encompassed in the shared monopoly charges that have been made. If the shared monopoly charges fail, by reason of either legal or factual insufficiency, respondents may not, under the instant complaint, be found to have violated Section 5 by reason of conspiracy.

To the extent that Judge Hinkes may be deemed to have amended the complaint to include the charge of conspiracy, such amendment would violate Section 3.15(a)(1) of the Commission's Rules. That section requires the filing of a motion for amendment and limits the authority of the ALJ to allow only such amendments that are reasonably within the scope of the original complaint. Neither requirement has been met here. Further, Judge Hinkes has issued no order of amendment.

The issue of conspiracy may not be considered to have been raised under the concept of conformance to the evidence (Section 3.15(a)(2)).

This, because the issue was not within the scope of the complaint, and the issue was not tried by express or implied consent of the parties, two requirements of Section 3.15(a)(2). To the contrary, complaint counsel's efforts to try the conspiracy issue have been contested by respondents every step of the way.

Notwithstanding my holdings with regard to conspiracy, in view of the fact that this case was allowed to be tried under a conspiracy theory and in light of the unusually long time it has taken to try this case and the voluminous record that has been compiled, I am going to make all findings called for by the evidence, including those relating to the issue of conspiracy.

The case was initially assigned to Administrative Law Judge Harry R. Hinkes for trial. Judge Hinkes was the ALJ during the [11] course of all of the pretrial, and he presided during the presentation of complaint counsel's entire case-in-chief. Both the pretrial and presentation of the case-in-chief were extensive. Prehearing conferences are reported at Tr. 1–2750. Formal hearings commenced on April 28, 1976, at Tr. 2753. Complaint counsel rested their case-in-chief on January 11, 1978, at Tr. 28,975.

At the close of complaint counsel's case-in-chief, all respondents filed motions to dismiss the complaint and to strike certain portions of the case-in-chief. Quaker's motion that the complaint be dismissed as to it was granted on February 24, 1978. Judge Hinkes deferred consideration of the other motions to dismiss until the conclusion of the entire case. By order of February 8, 1979, I denied requests of General Foods and General Mills for reconsideration of their motions to dismiss.

Judge Hinkes denied the motions to strike, by order of March 18, 1978, ruling that they amounted to, and should be considered together with, the motions to strike, thus effectively postponing the consideration of any such motions until the final arguments of the parties at the close of the record. By order of February 8, 1979, I denied General Foods' request for reconsideration of its motion to strike. Respondents, therefore, have been allowed to again raise at this time the motions to strike previously denied by Judge Hinkes.

After the consideration of various matters on the record (Tr. 28,976–29,228), respondents began their defense on April 25, 1978, at Tr. 29,229, with Judge Hinkes still presiding. On September 7, 1978, Judge Hinkes announced his impending retirement effective the end of that week and his intention to continue presiding in this matter under a special contract (Tr. 34,821–22). Hearings were continued on September 8, 1978 (Tr. 34,942–35,043), while Judge Hinkes was still an administrative law judge. Commencing September 12, 1978, and

continuing through September 28, 1978 (Tr. 35,044–35,984), Judge Hinkes heard seven defense witnesses at a time he was no longer administrative law judge. On October 12, 1978, the next date scheduled for hearings, counsel for Kellogg, in light of the pendency of a motion to determine that Judge Hinkes was disqualified from presiding over the hearing, declined to produce Kellogg's next witness (Tr. 35,986–35,990).

On December 11, 1978, following the Commission's determination, on December 8, 1978, that Judge Hinkes became "unavailable" within the meaning of 5 U.S.C. 554(d) upon his retirement, I was appointed substitute administrative law judge to preside over further proceedings.

On August 9, 1979, complaint counsel and counsel for General Mills and General Foods stipulated that the seven witnesses who testified before Judge Hinkes during the period September 9, 1978, through September 28, 1978, (*i.e.*, after Judge Hinkes had retired) if recalled, would testify under oath identically as they [12]had already testified, and that their testimony already given be accepted as part of the record. Documents offered and received in evidence during the period in question were also stipulated as accepted as part of the record. Kellogg refused to become a party to the stipulation. Accordingly, on August 27, 1978, I ordered that the stipulation and the testimony and exhibits stipulated to be accepted as part of the record, "applicable, however, only among the stipulating parties."[4] [13]

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[4] The testimony so stipulated into the record covers witnesses:
Richard B. Troxel (Tr. 35,044–35,273)
Rolf O. Berg (Tr. 35,274–35,352)
Arthur R. Schulze (Tr. 35,353–35,657)
Edward K. Bixby (Tr. 35,658–35,718)
Robert M. Cameron (Tr. 35,719–35,779)
Frank C. Blodgett (Tr. 35,780–35,874)
John L. Livingstone (Tr. 35,875–35,985)
The following exhibits were so stipulated into the record:
GMX 106 (CX–GM 173)
GMX 112 (CX–GM 2186)
GMX 116 (CX–GM 2190)
GMX 119 (CX–GM 2193)
GMX 124 (CX–GM 2474)
GMX 130 (CX–GM 561)
GMX 149 (CX–GM 129)
GMX 158
GMX 169
GMX 170
GMX 171
GMX 172
GMX 173
GMX 310–320
GMX 373
GMX 463
GMX 463A

(Continued)

When the Commission, on December 8, 1978, ruled that Judge Hinkes was unavailable and directed the appointment of a substitute ALJ, it also ordered the parties to file with the substitute ALJ briefs pertaining to the necessity and desirability of recalling and rehearing witnesses who had previously testified before Judge Hinkes. Respondents uniformly took the position that all witnesses should be reheard.

On February 21, 1979, complaint counsel filed a statement in support of their position that it was unnecessary to recall any witnesses. In that statement, complaint counsel "submit[ted] that there are no significant issues in this proceeding which turn crucially upon demeanor" (p. 2). It was stated that prior to Judge Hinkes' retirement on September 9, 1978, complaint counsel and respondents had presented 64 "fact witnesses" and that five more "fact witnesses" were presented by General Mills after Judge Hinkes' retirement (p. 9). With respect to these "fact witnesses," complaint counsel took the following position:

> Furthermore, thirty-six of complaint counsel's fifty-six fact witnesses were employees or former employees of respondents, as were the 13 fact witnesses called by respondents. If anyone is to suggest that the testimony of these fact witnesses should be taken at less than face value, it should be complaint counsel, toward whom most of these witnesses stood as agents of an adverse party. Nevertheless, complaint counsel are willing to rely upon the record evidence as a basis for any judgments of credibility that need to be made. If complaint counsel are willing to rely upon the record with respect to the credibility of these adverse witnesses, it is illogical for respondents, toward whom the witnesses were friendly, to insist they be recalled (pp. 10–11). [14]

On March 12, 1979, pursuant to my order of February 22, 1979, complaint counsel identified the "fact witnesses" referred to in their February 21, 1979 submittal and the pages of transcript covered by their testimony.[5] [15]

GMX 469
GMX 471
GMX 472
GMX 501
GMX 510–512
GMX 515–516
GMX 533
GMX 540
GMX 546–551
GMX 380 (CX–GM 2503A–Z23)
CX 2205
CX 2206
CX 2211

[5] The witnesses and pages of testimony so identified are as follows:

Witness	*Transcript Pages*
Dr. James R. Green	2889–3221
Eugene M. Schlenk	3222–3339
Dr. James R. Green	3340–3482

(Continued)

In my order of May 24, 1979, Denying [Respondents'] Motions For Hearing De Novo, I relied upon complaint counsel's concession and stated that "I shall accept the testimony of the [16]fact witnesses at

Jack W. Emry	3483–3622
Lawrence W. Corzine	3623–3770
Dr. James R. Green	3771–3835
Virginia Lee Laird	3836–3871
Betty Jean Dunham	3872–3894
Dr. Alan A. Fisher	3948–5824
Dr. James R. Green	5825–6430
Robert Calvin Bland	6462–7404
Joseph W. Pedersen	7405–7610
William E. Gentry	7611–8065
William H. Baumann	8066–8181
Biron A. Valier	8182–8296
Thomas N. Bezick	8297–8328
Henry T. Chandler	8329–8593
Ralph Boccella	8594–8654
Ben C. Irvin	8655–8791
Herman L. Stroup	8792–8871
Ralph Maron	8872–8930
Frank J. Kupka	8931–9071
Walter Steven Rubow	9072–9254
Richard F. Hurst	9255–9327
Richard W. Maurer	9328–9440
D.I. Ingraham	10682–10778
Jack W. Emry	10779–11056
Kenneth C. Englert	11219–11594
Jerry D. Wells	11595–11744
Howard M. List	11745–11919
Robert E. Hutson	11920–12122
Robert L. Nichols	12123–12743
Robert T. Bland	12744–12978
Charles A. Tornabene	12979–13238
Adolph S. Clausi	13393–13684
Wilfred H. Haughey	13685–13843
Eugene Raymond Mohlie	13844–14162
F. Kent Mitchel	14163–14334
Alvin Ossip	14335–14552
Larry D. Weiss	14553–14600
Max Randall Gould	14601–14884
Charles A. Hinman	14885–14938
John J. McBride	14939–15086
Kenneth Mason	15087–15248
James E. Legere	15249–15344
Robert A. Bowen	15345–15585
Harry E. Nickelson	15586–15651
Richard S. Sheehy	15652–15691
Vernon W. Cafarella	15692–16209
Joseph P. Manfrida	16210–16393
Vernon W. Cafarella	16394–16551
Robert F. Bodeau	16552–16836
Vernon W. Cafarella	16838–17145
Arthur R. Schulze	17146–17428
John Richard Schneider	17429–17495
Donald S. Schnitz	17496–17578
Arthur G. Yates	17579–17614
Arthur R. Schulze	17615–17842
Guy Lalone, Jr.	17843–17977
Preston Townley	17978–18038
Bernard J. Hogan	18039–18077
Alfred Boberg	18078–18125

(Continued)

face value and give it weight according to the overall testimony of the witnesses and the record as a whole" (p. 23). As for the expert witnesses who testified prior to my presiding, I have evaluated their testimony on the basis of the reasonableness and logic of their theories and economic conclusions, as I have done with respect to the experts who testified in my presence.

In so doing, I am in agreement with Kellogg's concluding witness, economic expert Dr. Robert Clower, who, when asked how the ALJ could decide which economic model or theory espoused in this case to accept, stated (at Tr. 40,175):

> I think this record contains an incredible amount of information for anyone who is seriously interested in comparing the kind of description of basic economic theory that is contained in the record at all levels, with the actual facts, and arriving, at least, at an informed judgment about which model makes the most sense.

In so appraising the expert evidence, I have found no need to evaluate the credibility of any expert witness who did not appear before me in the course of reaching the findings and conclusions that I make. Of course, to the extent any expert witnesses rely upon facts in reaching their conclusions or in giving opinions, which facts have not been established on the record, such conclusions or opinions are being afforded lesser or no weight.

This initial decision is based upon the entire record, including proposed findings of fact and conclusions of law and supporting memoranda filed by the parties as well as their answers, replies and

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Richard B. Troxel	18125–18421
Dianne B. Ellison	18422–18691
Owen B. Butler	25793–25887
Toby Ira Schreiber	25888–26070
Rudolf William Hirzel	29229–29537
Howard List	29537–29757
William E. LaMothe	29758–30132
Richard R. Walters	30133–30294
David E. Kinnisten	30295–30458
Howard L. Ross	32667–32779
William McKown	32780–33272
Richard B. Troxel	33368–33546
Todd S. Johnson	33547–33945
Richard B. Troxel	33946–34208
Michael J. Stevens	34209–34307
Boyd Sneddon	34308–34672
Rolf O. Berg	35274–35352
Arthur R. Schulze	35353–35657
Edward K. Bixby	35658–35718
Robert M. Cameron	35719–35779
Frank C. Blodgett	35780–35874

surreplies. The undersigned has also taken into account his observation of the witnesses who appeared before him[6] and their demeanor. [17]

Proposed findings not herein adopted, either in the form submitted or in substance, are rejected either as not supported by the evidence or as involving immaterial matters. In light of the 41,000 pages of transcript, 35 bound volumes of public exhibits, 16 binders of *in camera* exhibits and the extensive findings of fact, conclusions of law and supporting memoranda filed by the parties,[7] it is literally impossible to expressly and separately address each item of evidence and contention. Nevertheless, because of the salience and importance of this case, I am making factual findings in addition to those upon which I rely for disposition of the case so they may be available to a reviewing authority which may feel they are important in resolving any issues.[8]

ADMISSIBILITY OF DOCUMENTS PRODUCED FROM THE FILES OF RESPONDENTS

Before making any findings, it is necessary to consider respondents' uniform position that documents produced from the files of one respondent should be stricken as against all other respondents.

During the course of the trial, Judge Hinkes established the rule that documents produced from the files of any respondent, which were not forgeries, would be admitted into evidence conditionally against all respondents, subject to establishing a connection with those respondents other than the one from whose files the documents were produced. On February 22, 1978, following the close of complaint counsel's case-in-chief, each respondent moved to have stricken as to it all documents procured from the files of other respondents or from the files of any other entity.

General Foods identified over 2,000 documents (totalling some 10,000 pages) which it sought to have stricken. These documents came from the files of Kellogg, General Mills, Quaker, the Cereal Institute, Nabisco, the National Commission on Food Marketing, Ralston, A.C. Nielson Co., A&P and Procter and [18]Gamble. General Mills, without identifying specific documents, moved that all documents originating with the other respondents be stricken as to it. In light of General Mills' assertion that the vast majority of the

[6] I heard witnesses starting at Tr. 36,307.

[7] The following were filed: CP–769 pages; KP and KPL–971 pages; GMP–554 pages; GFP–698 pages; IP–43 pages; CR–576 pages; KS–330 pages; GMS–83 pages; GFS–698 pages; IS–30 pages—a total of 4,752 pages.

[8] Note, *e.g.*, my decision to make findings on the issue of conspiracy, notwithstanding my ruling that the complaint fails to charge conspiracy.

documentary evidence originated with respondents other than General Mills, it may be assumed that General Mills' motion to strike encompassed a larger number than the 2,000 documents covered by General Foods in its motion. The documents covered by Kellogg's motion to strike are listed on some 50 pages of its motion and include documents secured from General Mills, General Foods, Quaker and Ralston.

As related above, both Judge Hinkes and I refused to consider the motions to strike, ruling that such motions should await the final briefing. Respondents have now renewed their motions to strike.

Respondents' contentions underlying their motions to strike fall in two categories: (1) a lack of connection between the document and the moving respondents, and (2) the hearsay nature of the document, inasmuch as the author was not produced and so could not be cross-examined by the respondents.

1. *Connection between the documents and the moving respondents.*

The shared monopoly theory of this case is that, given the structure of the RTE cereal industry, the actions (or conduct) of each individual respondent, considered in conjunction with the actions of other respondents and others in the industry, have served to maintain a highly concentrated, noncompetitive market structure, to obtain, share and exercise monopoly power and monopolize, and to erect, maintain, and raise barriers to entry. The acts of each respondent which bear upon the allegations of the complaint, therefore, are relevant in appraising the acts and practices of the other respondents. Therefore, there is no substance to the general allegation that documents produced from the files of one respondent which describe the conduct of that respondent bear no relationship or connection to the other respondents.

For example, each respondent would have stricken as to it the price lists of the other respondents, for the reason that each company's price lists reflect only its own prices. While each price list shows only the pricing conduct of the issuing company, the price lists of all respondents show the aggregate pricing conduct of practically the entire industry. Under the complaint, which in large part relies upon economic theories flowing from the central theory of analyzing the structure, conduct and performance of an industry, each price list is relevant or connected to all respondents. While each respondent is to be tried on the basis of its own conduct, the theory of the

case requires consideration of that conduct in the light of that of the other respondents. **[19]**

Respondents rely upon the principle applicable in conspiracy cases that there must be independent evidence of the existence of a conspiracy, and the participation of a party in the conspiracy, before declarations of an alleged co-conspirator in the course of executing or furthering the conspiracy may be admitted against another respondent. *See, e.g., United States* v. *Nixon,* 418 U.S. 683, 701 (1974); *United States* v. *Kessler,* 530 F.2d 1246, 1256–57 (5th Cir. 1976); *Flintkote Co.* v. *Lysfjord,* 246 F.2d 368, 378 (9th Cir.), *cert. denied,* 355 U.S. 835 (1957). The shared monopoly charge, however, is not a conspiracy matter as to which the above principle would apply.

Respondents assert that there is no legal basis for trying the charges of the complaint; that the documents secured from one respondent, therefore, are not relevant to the others under any recognizable theory of law. However, the only means by which to ascertain whether the acts and practices and methods of competition of the several respondents constitute unfair methods of competition within the meaning of Section 5 is to admit evidence of the acts and practices and methods of competition of the individual respondents and evaluate them in their aggregate.

Even though particular admissions or declarations against interest of one respondent may not be used directly against other respondents without being connected, they may be admissible against the party from whose files they were secured to show its individual activity or purport. This, in turn, could be considered in evaluating the environment within which the activities of all respondents are to be judged. Further, in addition to evaluating the overall situation of the industry, the acts of the individual respondents, quite apart from allegations of conspiracy or agreement, would be relevant under the theory that respondents have engaged in price leadership in lieu of overt agreement and have otherwise acted in concert or in similar fashion by reason of the their interdependent coordination induced by the structure of the RTE cereal industry.

As noted above, respondents contend that the shared monopoly aspect of this case fails as a matter of law. As I have also previously noted, I believed it inappropriate to consider motions to dismiss apart from a full consideration after completion of the entire case. Similarly, irrespective of my disposition of this matter, I believe it to be important not to strike evidence relevant to complaint counsel's theory of violation so that a reviewing authority may have a full record upon which to appraise that theory.

Returning to the conspiracy issue, I have already ruled that the complaint does not encompass the charge of conspiracy but that I shall, nevertheless, make findings on that issue. The cases relied upon by respondents, in asserting that documents taken from the files of one respondent are inadmissible against **[20]**the others, deal with the necessity of proving the existence of a conspiracy by independent evidence before declarations of a conspirator may be admitted against his co-conspirators. However, in a tacit conspiracy case, there is no evidence of express, verbal agreement. Conspiracy must be established through the conduct of the several alleged co-conspirators. *American Tobacco Co.* v. *United States,* 328 U.S. 781, 809–10 (1946); *United States* v. *Bausch & Lomb Optical Co.,* 321 U.S. 707, 723 (1944); *United States* v. *Consolidated Packaging Corp.,* 575 F.2d 117, 126–27 (7th Cir. 1978).

The cases cited above, and many others, reveal that there are many varying considerations to be taken into account in determining whether the business activities of individual respondents, as indicated by their own business documents, may be evidence of a tacit conspiracy. Consequently, a blanket ruling covering the thousands of documents objected to by respondents is not possible. It is necessary to evaluate each document in question, to the extent relevant to a particular issue, to ascertain, for example, whether it constitutes an act or recitation, and whether it constitutes an act or activity irreconcilable with independent business judgment of the particular respondent. To the extent such identical or closely related irreconcilable acts and practices are shown as to the several respondents, a conspiracy may be evidenced.

In my opinion, as explained below, complaint counsel have failed to establish that respondents conspired to monopolize or to maintain a monopoly. The relevant documents considered in reaching that conclusion are not being stricken.

2. *Hearsay Nature Of The Documents*

Each respondent moves to strike documents produced from the other respondents' files on the ground the documents are hearsay as to it and it has not had the opportunity to cross-examine the person who prepared the document.

Section 3.43(b) of the Commission's Rules of Practice provides for the admission of relevant, material and reliable evidence. It does not exclude hearsay evidence, and hearsay evidence may be received. *Philadelphia Carpet Co.,* 64 F.T.C. 762, 773 (1964); *Phelps Dodge Refining Co.* v. *FTC,* 139 F.2d 393, 397 (2nd Cir. 1943); *Hoover* v. *Beto,*

467 F.2d 516 (5th Cir.), *cert. denied,* 409 U.S. 1086 (1972). As stated in *Lenox, Inc.,* 73 F.T.C. 578, 604 (1968), "Clearly documents coming from a respondent's files can be regarded as reasonably reliable absent some countervailing evidence demonstrating their unreliability." In receiving the documents in question in evidence, the administrative law judge has already ruled upon their reliability, subject to the connection with other respondents for purposes of showing relevance and materiality, discussed above. **[21]**

This, of course, leaves the question of the weight to be given a particular document. In deciding that question, it is necessary to consider such matters as the circumstances surrounding the preparation of the document, its author, and the extent to which its contents are corroborated or are consistent with other evidence.

Accordingly, each respondent's blanket request that all of the thousands of documents produced from the files of the other respondents be stricken is being denied. Rather, each such document considered will be afforded the weight to which it is entitled in the course of making the particular findings that follow.[9]

COMPLAINT COUNSEL'S THEORY OF VIOLATION

Complaint counsel's theory of how respondents violated Section 5 of the Federal Trade Commission Act is summarized at CP 1–20 (CPF 1–50). The following recitation is derived from that summary.

Consumers are being overcharged for RTE cereals because they are being deprived of the benefits of competition. Kellogg, General Mills, and General Foods have maintained a pattern of conduct that has enabled them to charge supracompetitive prices and to reap monopoly level profits. The fact each respondent gains these enormous monopoly profits as a result of their conduct demonstrates that they are sharing monopoly power.

"In the most traditional antitrust sense, the three respondents have tacitly colluded and cooperated to maintain and exercise monoply power—'power over price' and 'power to exclude' additional competitors." Respondents' conduct has regulated and suppressed competition in the RTE cereal market and has caused consumer prices to be substantially higher than if this were a more competitive market.

Respondents' monopoly power will continue to injure consumers unless greater competition is encouraged. This can be done by bringing additional competitors into the market. **[22]**

[9] Among such documents are many that simply aid in understanding the industry by providing industry description or background. They do not purport to constitute evidence of conspiracy or of interdependent behavior.

The Commission should dissipate respondents' monopoly power because respondents have eliminated competition among themselves and have raised barriers to entry. Therefore, the Commission should issue an order requiring respondents to create five strong new firms from their assets; and should encourage the entry of additional firms into the industry by requiring respondents to grant royalty-free licenses of brands they continue to own after the divestiture. This would encourage competition and prices would fall toward competitive levels.

The complaint charges that the three respondents and Quaker have collectively and individually engaged in acts and practices which maintained a non-competitive, monopolized market in the sale of RTE cereals. The main issues are consumer injury and the exercise of monopoly power by respondents.

RTE cereals constitute a large ready-to-eat product market with retail sales of over $740 million in 1970 and about double that in 1975.

Complaint counsel's proposed findings are organized according to a structure-conduct-performance framework of analysis. This describes a causal flow from an industry's structure to its behavior or conduct, and ultimately to its economic performance.

The RTE cereal industry is highly concentrated and is marked by high barriers to the entry of new firms. There are no barriers to entry unrelated to respondents' conduct. Respondents' conduct, therefore, explains the absence of entry by new firms which otherwise would pursue the extraordinary high profits in the market and seek a share of the rapid growth thereof.

The RTE cereal industry is highly concentrated at the six firm, four firm and three firm concentration levels. Since at least 1940, there have only been six significant producers of RTE cereals: Kellogg, General Mills, General Foods, Quaker, Nabisco and Ralston, of which respondents have always been the three largest.

New firms normally enter markets where profits are above the level that can be earned in alternative investments. Further, new entry is generally more attractive and easier in growing industries.

The RTE cereal industry is enormously profitable. This is shown by the accounting rates of return on capital employed by the industry as a whole, as well as the accounting rates of return for Kellogg, General Mills and General Foods individually, compared to the rate of return for the manufacturing sector of American industry. This conclusion is also true when alternative calculations are made which adjust for potential biases in the accounting rates of return. **[23]**

The RTE cereal industry has grown more rapidly than the United States economy as a whole. Despite the high profitability and rapid growth of the RTE cereal industry, no new firm had entered the industry from 1950 to 1972. The lack of entry into the apparently attractive RTE cereal industry must be caused by barriers to entry. Neither of the traditional nonconduct barriers to entry—economies of scale and the ownership of specialized resources such as patents—are present here. The only possible explanation for the lack of new entry lies in the respondents' conduct of introducing a large number of intensively advertised, trademarked RTE cereal brands which has had the effect of raising barriers to entry into the industry.

In highly concentrated industries, where only a few firms control most of the output, each firm may recognize that its competitive actions may have direct effects on the other large firms in the industry and may cause the others to respond in predictable ways. Recognizing their interdependence, each firm recognizes that it is in their collective best interest to avoid taking competitive actions which will result in the other firms reacting competitively. Therefore, if each firm manages to communicate or signal its decision to the others not to use certain competitive weapons and to follow the leadership of other firms, the small group of sellers may reach understandings with each other. The understandings can arise by reason of the firms' patterns of conduct without oral or written communication among them. These patterns of conduct can become long standing and become the rules of the game to which each firm will abide.

The respondents have adopted and adhered to certain rules of the game and, thereby, have suppressed the use of a wide variety of competitive weapons. Whereas the RTE cereal firms were highly price-competitive through the early 1950's, they reached an understanding with others to eliminate some of their more competitive price activities, as well as others, which could have reduced industry prices and profits. Having avoided such competitive action, the respondents channeled their competitive energies into brand proliferation. This raised barriers to the entry of new firms which otherwise would have entered. Thus, respondents have been able to earn monopoly profits for a substantial period of time.

Monopoly power is the power to hold prices above a competitive level of costs. Respondents exercised that monopoly power by coordinating their activities so as to suppress price and other forms of competition. They reached an understanding to minimize the use of trade deals, cents-off labels, and in-pack premiums. Kellogg and General Foods acquired two of the larger producers of private label

RTE cereal products; and, thereafter, respondents reached an understanding to terminate or [24]greatly reduce the sale of private label products. Respondents arranged through the A.C. Nielsen Company to exchange current detailed RTE cereal advertising information whereby they were able to coordinate a reduction in advertising expenditures when sales growth slowed in the late 1960's, and were able to avoid misunderstandings regarding each other's advertising strategies. In the late 1950's, each respondent adopted a shelf space plan based on common principles. The respondents avoided engaging in fortification competition prior to 1970, at which time they came to an understanding that they would fortify all of their RTE cereal products to comparable levels at about the same time.

The respondents avoided list price competition among themselves and tacitly colluded to increase prices by adopting a system of collusive price leadership in which Kellogg was usually the price leader, and General Mills and General Foods raised their price in consonance with Kellogg so as to maintain prices at the monopoly level.

The furnishing of private label products constitutes an important form of price competition. Respondents avoided this form of price competition by refusing to provide private label RTE cereals, despite respondents' available production capacity and a substantial demand by their customers for private label products.

The discontinuance of the powerful competitive tools of trade deals, in-pack premiums and cents-off labels could not have occurred without an understanding among respondents.

Retail shelf location is an important factor in the success or failure of an RTE cereal brand. By adopting virtually identical shelf-space plans and by reason of General Mills' and General Foods' tacit adoption of Kellogg's control of the retail shelves, so long as Kellogg allotted each of the other two respondents a fair share of the space, respondents suppressed competition among themselves and placed smaller firms and potential entrants in inferior and less desirable shelf locations.

Respondents refrained from fortifying most of their RTE cereal brands until they were spurred to do something by public criticism. Then, the respondents met at their industry association, The Cereal Institute, where they reached an understanding as to what each was going to do, *i.e.,* increase their fortification to comparable levels within a relatively short time.

Respondents suppressed competition among themselves by their exchange of current advertising data through the A.C. Nielsen

Company. Monthly or bi-monthly advertising data by brand and by advertising media were furnished to Nielsen which compiled the [25] data into a comprehensive industry report and distributed the information to each firm within two months of the actual expenditures. This allowed the respondents to coordinate their advertising efforts.

Normally, in view of respondents' monopoly profits and the industry's growth, new firms would have entered the market with competitive impact. However, there was no such entry because of respondents' conduct. By suppressing and avoiding the various forms of competition narrated above and in channeling substantially all of their efforts to increase sales into the introduction of a large number of intensively-advertised, trademarked RTE cereals ("brand proliferation"), respondents have persistently continued their monopoly profits while a new firm entering the industry would expect to operate at a loss. In this manner, respondents erected a barrier to entry.

Respondents' brand proliferation created a barrier to entry because RTE cereal brands are highly differentiated, with each brand having only a few directly competitive other brands. Thus, a price change of a particular RTE cereal brand will directly affect only a few, closely substitutable brands. This localized competition means that in order for a firm to introduce a new RTE cereal, the new brand must take a significant portion of its sales from the few brands with which it must compete most directly. In addition, a new RTE cereal brand must gain a minimum level of sales in order to be successful. This means that if there are a number of existing brands in the segment aimed at by the new product, there is not room for a new product to enter, although the existing brands can continue to make substantial profits. This situation exists in a number of the areas or segments of the RTE cereal market.

Existing firms are able to introduce new brands, while new companies cannot, because of certain advantages. One advantage is that an existing firm can preempt a profitable new product opportunity before a new entrant can act. One reason is that a manufacturer of RTE cereals must have from 3.5% to 5% of the market without being at a significant cost disadvanatage relative to other firms (firm economy of scale). Thus, one of the respondents, which already has much more than 3.5% of the market, can introduce an additional single brand while it is satisfying its firm economies of scale. An outsider would have to launch several brands at the anticipated level of 1% (brand economy of scale) before it could reach a firm efficiency scale approaching 3.5%.

Potential entrants can reasonably expect that their brand introductions would be subject to more vigorous competition from existing RTE cereal producers than would the brand introductions of respondents. A respondent could not react to a brand introduction of an existing competitor without breaking the rules of the game, and it could then expect a competitive [26]response throughout the cereal industry. On the other hand, a respondent could react to a single brand entry of a new company in the particular localized area where the new brand was competing while its other products would continue to reap monopoly profits.

Apart from preemption or retaliation, respondents' brand proliferation has made entry into the RTE cereal industry by outsiders less likely because it has significantly increased the costs which a new entrant would have to incur. This is because brand proliferation has decreased the size or share of market enjoyed by any individual brand and has increased the rate of failure of brand introductions. Thus, the outsider could not hope to introduce a single brand which would get enough return to make it worthwhile. It would be required to introduce multiple brands (some successful and some unsuccessful) with the increased costs of having to research and develop, advertise, and promote and market a number of products, each with its own costs. This increase in capital costs would eliminate potential smaller firms which could not raise the necessary capital and would even make the larger potential competitors more cautious before they might venture an entry into the RTE cereal market.

Economic performance of the RTE cereal industry is poor. One measure of the poor economic performance is respondents' high monopoly prices and profits. With prices so artificially inflated at monopoly levels, consumers purchase less than they would if prices were at lower competitive levels. Since less RTE cereal is produced, fewer resources are devoted to the manufacture and distribution of RTE cereals than would be employed in a competitive market.

Because of respondents' high profits, consumers have been inequitably overcharged. If prices were at lower, competitive levels, manufacturers would provide RTE cereals to the consumers at lower prices at which consumers would demand, and producers would supply, more RTE cereal. This would provide additional employment.

When firms reap monopoly profits, there is an incentive to increase costs, including advertising expenditures, above those which would prevail in a competitive market. This is because the profit to a firm for selling an additional unit of output is greater than if the prices were at a lower, competitive level. Firms charging

higher prices, therefore, have an incentive to spend additional amounts on promotional activities in order to sell additional units of the commodities and gain higher returns. Therefore, monopolists are willing to incur higher costs than competitive firms would be willing to expend. Further, the channeling of rivalry into brand proliferation has required an increased amount of advertising and promotional expenditures as each new cereal is introduced. If additional price competition were restored to the industry and product [27]proliferation were decreased, advertising and other promotional expenditures would fall toward competitive levels, as would prices. The exorbitant advertising and promotional costs have been passed on to consumers in respondents' monopoly prices.

"Only substantial structural relief holds the prospect of significantly improving the performance of the industry." Complaint counsel's proposed order includes provisions requiring divestiture by spin-off, mandatory royalty-free trademark licensing, a ban on future acquisitions, and a ban on shelf space plans.

Kellogg would be required to divest itself by spin-off of three viable firms. General Mills and General Foods would each be required to divest itself by spin-off of one viable firm. Each divested firm would be capable of producing at least 5% of industry output and would be granted exclusive rights to manufacture and distribute trademarked cereal brands formerly owned by the parent firm. This divestiture requirement, by increasing the number of firms in the industry, would substantially lessen the possibility that the firms in the industry could tacitly collude to avoid competition.

The trademark licensing provision would require that respondents offer to license royalty-free for 20 years any RTE cereal brand remaining in their possession after the divestitures. Any new RTE cereal brand introduced by a respondent would become subject to the licensing requirement five years after it was introduced into national distribution.

The spin-off provision would have at least three important competitive effects. First, it would create the potential for direct competition between the remaining RTE cereal products of the respondents and the licensed versions of those brands. Second, it would lower barriers to entry for new firms, since a new firm by license could get a new product immediately. Third, the five divested firms could use this additional licensing provision to utilize the remaining portion of their productive capacities not utilized by the products exclusively licensed to them by the parent firms.

The proposed ban on acquisitions by the respondents for 20 years

would inhibit the reconcentration of the industry following divestiture.

The ban on shelf space programs would prohibit respondents from making shelf space recommendations covering the entire RTE cereal section. Each firm could continue to make recommendations concerning the shelving of its own brands. This provision would restrain respondents from making it more difficult for new entrants and smaller producers to obtain better shelf space. [28]

Monopoly power is power over price and power to exclude competitors. The existence of such power finds support in the combined market shares of the respondents. "However, proof of monopoly power in this case rests primarily on the evidence that each of the respondents gained monopoly profits over a long period of time." Monopoly power is also demonstrated by the respondents' exercise of their power to exclude further competition by reason of their brand proliferation.

Respondents are said to have violated Section 5 of the Federal Trade Commission Act because their conduct violates the Sherman Act prohibitions against conspiracies to monopolize. This is evidenced by the overall understanding among respondents to abide by certain rules of the game whereby respondents suppressed and avoided various forms of competition and channeled their activities into brand proliferation which, in turn, led to the erection of barriers to entry.

Conduct may violate Section 5, whether or not it is held to have violated the Sherman Act. Respondents' cooperative conduct is said to violate the policies of the antitrust laws and is, therefore, an unfair method of competition. Respondents have been unfair to consumers in terms of the monopoly overcharges that have resulted from their conduct, and respondents have been unfair to competitors because they have barricaded the market against additional competitive entry.

Complaint counsel have further explained their theory of the case at CP 54–61 (CPF 6–1 through 6–19) from which the following additional recitation has been derived.

Complaint counsel rely for their evaluation of the RTE cereal industry and the behavior of the major RTE cereal producers in accordance with the structure-conduct-performance framework of economic analysis. This demonstrates that the highly concentrated structure of the RTE cereal industry enabled respondents tacitly to collude or cooperate to avoid a wide variety of competitive activities which would have eroded the monopoly profits they enjoyed. Instead, respondents introduced a large number of intensively advertised,

trademarked RTE cereal brands, with the effect of creating a brand proliferation barrier to the entry of new firms. This allowed respondents to charge monopoly prices and earn monopoly profits which are the measure of poor economic performance. The structure-conduct-performance framework may also be used to evaluate complaint counsel's proposed remedy.

The basic principle underlying the structure-conduct-performance framework is that the structure of an industry may affect the behavior or conduct of its members which, in turn, **[29]**determines the quality of the industry's performance. There may also be feedback effects inasmuch as firm conduct may affect structure.

Structural characteristics of an industry include the number of sellers and their relative sizes, concentration, and the existence of barriers to the entry of new firms. Important conduct features of an industry include pricing practices and product policies, including the kinds and numbers of products to offer, and how products should be physically differentiated, as well as advertising and research and development policies, and innovation.

The economic performance of an industry falls into three broad categories: efficiency, equity, and progressiveness.

One. Efficiency. This includes a determination of whether an industry manufactures and distributes its products at the lowest possible cost and whether the optimal amount of society's resources are devoted to producing the industry's products. An example would be a monopolist which restricts output in order to raise prices and increase its profits. This would result in consumers purchasing less at monopoly prices than they would if there were lower, competitive prices. With less products being produced, the monopolist employs fewer resources than under a competitive environment. Enjoying inflated monopoly profits, the monopolist may not hold its costs at their lowest possible levels as it would attempt to do in a competitive market.

Two. Equity. This includes a determination of whether the prices consumers are paying are higher than necessary to attract capital investment into the industry. When this occurs, there is unnecessary and inequitable transfer of income from consumers to producers.

Three. Progressiveness. This concerns the extent to which suppliers have taken full advantage of scientific and technological opportunities to provide the best possible products made by the most efficient production processes available.

In a competitive market, *i.e.,* one where the structure of an

industry is such that there are many sellers, prices and profits will tend to equal costs (costs being defined to include a normal profit). This is good economic performance. When there is a single monopolistic seller, there is a tendency for the seller to raise prices in excess of costs and so earn excess or monopoly profits. This indicates poor industry performance. Between the extremes of pure competition and monopoly, there may be oligopoly. In an oligopolistic industry, the prices may gravitate toward costs (the competitive result) or they may tend to be in excess of cost (the monopolist result). **[30]**

In an oligopoly, where you have few sellers each of considerable size, the sellers often recognize that each seller's actions may materially affect the fortunes of the others; that their fortunes and decisionmaking are interdependent. The oligopolists are likely to realize that, if they work together and coordinate their actions, they may achieve monopoly profits by sharing the monopoly power they possess as a group. If there is a barrier to the entry of new firms, they would be able to sustain monopolistic profit levels without the threat of new competition coming into the industry.

There is a great incentive for sellers in an oligopoly to coordinate their activities rather than to engage in aggressive competitive actions which may lead to retaliatory actions by their rivals. Thus, sellers in an oligopoly may achieve a monopoly result by tacitly colluding or by pursuing a cooperative policy. Even if they do this, if there is no substantial barrier to entry, new entrants would be attracted to the industry who would add additional competition. However, if there is a barrier to the entry of new firms, the oligopolists would be able to sustain their monopolistic profit levels without the threat of competition from the outside.

In order to determine whether a market is operating in a competitive or a monopolistic manner, or close to one of those extremes, a careful analysis of the structure of the industry and of the conduct and performance of its sellers must be undertaken (CPF 6–16).

Having demonstrated that the RTE cereal market's highly concentrated structure contributes directly to respondents' conduct in tacitly colluding and cooperating to avoid competition and to raise prices to monopoly levels, *i.e.,* that the respondents' conduct and the ultimate poor performance of the RTE cereal industry flow from the industry's structure, it is clear that an effective remedy requires structural relief. "So long as the structure of the RTE cereal industry is unchanged, it is unlikely that an order directed solely to the firms' conduct will result in more vigorous competition and improved economic performance" (CPF 6–19).

From complaint counsel's own analysis of what they purport to show, it can be seen that they have assumed a formidable burden of proof. Having outlined the elements of complaint counsel's theories of violation, we can now turn to what the record actually shows. [31]

Findings of Fact[10] and Discussion

I. THE RESPONDENTS AND OTHER PRODUCERS OF RTE CEREAL

1. The relevant product market, as found in the next section, is the RTE cereal industry. The six major producers in the industry are the three respondents and Quaker, Nabisco and Ralston (CX 106A–G).

A. *Kellogg*

2. Kellogg, founded in 1906, is a Delaware corporation with its principal office and place of business located in Battle Creek, Michigan. Kellogg and its wholly-owned subsidiaries manufacture and sell, among other things, RTE cereal products (its principal business), tea, soup, gelatin, and puddings (Kellogg Answer, ¶ 3; Tr. 11,936–38, 12,173–74; CX–K 746G). In 1968, RTE cereals accounted for approximately 87% of Kellogg's net sales; in 1970, this figure was about 75% (CX–K 1090Q). Kellogg is the largest producer of RTE cereals. In 1950, Kellogg's share of the total RTE cereal market was [32]between 35% and 37%, on either a pound or dollar sales basis; in 1970, it had approximately 44% of the market, on either basis (CX 106A–G).

3. Kellogg has both domestic and foreign subsidiaries. The part of Kellogg that has responsibility for manufacturing RTE cereals in the United States is called Kellogg Company, U.S. The Kellogg Sales Company subsidiary encompasses the field selling force of Kellogg. Kellogg International has responsibility for the sales of Kellogg RTE cereals in countries other than the United States (Tr. 11,925–26, 11,930–31, 11,939).

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[10] Findings of fact, for the most part, are made in numbered paragraphs. Discussions and applications of findings, as well as consideration of legal and other matters, appear where deemed appropriate. Some precede or follow particular findings which pertain thereto; others follow all of the numbered findings. Findings which appear in unnumbered paragraphs are, nevertheless, findings.

The record contains a considerable amount of economic testimony. When I cite the testimony of an economist under findings of fact, it may mean that I am accepting the economic principle, theory or conclusion testified to as a finding in this matter. And when I do so, that necessarily means that I have rejected other contrary or inconsistent economic positions. On the other hand, it may simply indicate that an economist has testified to or espoused a particular economic proposition without my necessarily accepting that economic proposition as a fact. The nature of my treatment of such economic evidence will be apparent from the finding.

Many of the conclusions reached by economic experts are based upon other evidence in the record. The weight to be given such economic conclusions, of course, depends upon, and varies with, the reliability of the evidence relied upon as well as the economic witnesses' accuracy in relating and interpreting the relied upon evidence.

4. Until 1939, Kellogg manufactured RTE cereal products only at Battle Creek, Michigan (CX–K 1097A). In 1943, it acquired the business and certain assets of the Miller Cereal Company in Omaha, Nebraska, and leased, with an option to purchase, the manufacturing facilities. In 1958, Kellogg purchased these facilities (Kellogg Answer, ¶ 11). From 1963 to 1970, Kellogg manufactured RTE cereal at four plants in the United States: Battle Creek, Michigan; Memphis, Tennessee; Omaha, Nebraska; and San Leandro, California (CX–K 1079A; Tr. 11,926). Today, Kellogg has another plant in Lancaster, Pennsylvania (Tr. 36,583–84). Kellogg also has RTE cereal manufacturing facilities in 17 foreign countries and sells its RTE cereal products in more than 130 countries (CX–K 1090R).

5. In 1970, Kellogg Company had RTE Cereal Operations assets of $179 million (CX 757B). In 1950 and 1970, Kellogg's RTE cereal sales were $64,922,000 and $308,944,000, respectively. Pound sales for 1950 and 1970 were 258,604,000 and 591,707,000, respectively (CX 430C - Tables, p. 11 "C–Kellogg," received into evidence as GFX 1319).

B. *General Mills*

6. General Mills is a Delaware corporation with its principal office and place of business located in Minneapolis, Minnesota. General Mills is a diversified company manufacturing and selling, among other things, RTE cereals, flour, toys, chemicals, clothes and jewelry (General Mills Answer, ¶ 2B).

7. Prior to 1969, General Mills' RTE cereal business was a part of its Grocery Products Division with several functional areas: a manufacturing division, a sales division, a marketing division, and a comptroller (Tr. 18,145). In 1969, General Mills reorganized its divisions which had responsibility for RTE cereals and created the following divisions within the general framework of its Consumer Foods Group: (1) the Big G Division, which is responsibile for all marketing of RTE cereals and associated products; (2) the Packaged Food Operating Division, which manufactures all products of the Consumer Food Group with the exception of family flours; (3) the Grocery Products Sales Division, which sells all products of the [33] Consumer Food Group with the exception of institutional products; and (4) the Sperry Division, which is responsible for institutional sales (Tr. 18,132–33, 18,135–36, 18,140–41; CX–GM 2041).

8. General Mills operates RTE cereal plants in Buffalo, New York; South Chicago and West Chicago, Illinois; Toledo, Ohio; and Lodi, California (CX–GM 2119; Tr. 18,133). RTE cereal represents

between 40% to 60% of production for each of these plants (Tr. 18,133–34; CX–GM 2119).

9. In 1970, General Mills had RTE cereal operations assets of $66.9 million (CX 754D). Its sales of RTE cereal for fiscal year ending May 1951 were $33,224,000 and 125,481,000 pounds; sales for fiscal year 1970 were $141,775,000 and 269,427,000 pounds (CX 430C - Tables, p. "C–GMI," received into evidence as GFX 1319). General Mills' share of the total RTE cereal market for both 1950 and 1970 was approximately 20% on either a pound or dollar basis (CX 106A–G).

C. *General Foods*

10. In 1895, Charles William Post began to produce Postum Cereal, a grain-based cereal beverage, as a coffee substitute. In 1896, he organized the Postum Cereal Company, Ltd. (a partnership association limited) in Battle Creek, Michigan to market this product. Mr. Post developed Grape Nuts cereal, and introduced it in 1898 (GFX 1234D, E, 1370A, B).

11. In 1899, Mr. Post founded the Battle Creek Paper Company Ltd. to provide cartons and containers for his products. This company evolved into the present Carton & Container Division of General Foods Corporation, which provides packaging for various General Foods products—including RTE cereals—as well as for some contract customers (GFX 1226F, 1370B).

12. In 1904, the Postum Cereal Company introduced a corn flake product named Elijah's Manna. In 1907, this product was renamed Post Toasties. In 1922, the Postum Cereal Company introduced its third RTE cereal—Post's 40% Bran Flakes—which, like the first two, remains in distribution today (GFX 1226F, 1234E, 1370B).

13. In the late 1920's, the company moved outside the cereal category and expanded its product line to include gelatin desserts, flours, puddings, chocolate, coconut, syrup, coffee, baking powder, fruit pectin and frozen foods. In recognition of this development of its lines of business, in 1929, the name of the Postum Cereal Company was changed to General Foods Corporation (GFX 1226D, 1370C).

14. In 1943, General Foods acquired the Jersey Cereal Company of Irwin, Pennsylvania, a manufacturer of private label and controlled brand RTE cereal, with plants in Irwin and St. Joseph, **[34]** Missouri (Tr. 12,143–44, 13,714). General Foods subsequently closed the Irwin and St. Joseph plants and moved their operations to Battle Creek (CX–GF 121G).

15. General Foods is a Delaware corporation with its principal

office and place of business located in White Plains, New York. General Foods produces and/or sells, among other things, RTE cereals, baking powder and ingredients, coffee, beverages, nuts, popcorn, frozen foods, syrups, pancake mixes, pet foods, and gelatin and other desserts (General Foods Answer ¶ 11(b); GFX 1242–79, 1370C). Since approximately 1965, General Foods has been the third largest producer of RTE cereals, which are sold under its "Post" label; before 1965, General Foods had been the second largest RTE cereal producer (CX 106A–G; GFX 1370J).

16. During the period of time covered by the complaint, all of General Foods' RTE cereals were manufactured in Battle Creek, Michigan (CX–GF 562). General Foods now has an additional RTE cereal manufacturing plant in Modesto, California (Tr. 36,658–59, 36,966).

17. After an internal reorganization in 1946, General Foods began to manufacture and market its RTE cereals in the United States through its Post Cereals Division. In the early 1970's, as a result of further organizational changes, a newly formed Beverage and Breakfast Division assumed responsibility for General Foods' RTE cereal business, and the Post Division was eliminated (Tr. 16,215–20; CX–GF 167).

18. In 1970, the RTE cereal operations assets of General Foods were over $44.9 million (CX 752B). General Foods' sales of RTE cereals for fiscal year 1950 were $25,785,000 and 126,000,000 pounds; in 1970, sales were $94,242,000 and 225,730,000 pounds (CX 430 C - Tables, p. "C–General Foods," received into evidence as GFX 1319). In 1950, General Foods' share of the total RTE cereal market was approximately 22% based on dollar and pound sales. By 1970, these market shares had declined to approximately 17.7% based on pound sales, and 14.8% based on dollar sales (CX 106A–G).

D. *Quaker*

19. The Quaker Oats Company is a New Jersey corporation with its principal office and place of business in Chicago, Illinois. It was incorporated in 1901. Quaker manufactures and sells, among other things, RTE cereals, to-be-cooked cereals, mixes, frozen foods, cookies, pet foods, and chemicals (Quaker Answer ¶ 2D; Tr. 15,389–90). As of 1970, Quaker produced RTE cereals in plants located in Cedar Rapids, Iowa; Depew, New York; Shiremanstown, Pennsylvania; and Danville, Illinois (Tr. 15,390; CX Q 576). Quaker has both domestic and foreign subsidiaries (Tr. 15,398–99).

20. Quaker's share of the RTE cereal market, based on pound

sales, was between 4.1% and 5.0% in 1950, dropped to approximately [35]2.4% in 1960, and rose to about 7.0% in 1970. Quaker's market share, on a dollar sales basis, went from 6.6% in 1950 to approximately 9.0% in 1970 (CX 106A–G).

E. *Nabisco*

21. Nabisco is headquartered in New Jersey (Tr. 3224). It is engaged principally in the manufacture, processing, and sale of food products in the United States and foreign countries. Its products include biscuits, cookies, crackers, hot cereals, RTE cereals and pet foods (CX–GF 3000Z–139). Nabisco's major RTE cereal products are Nabisco's Shredded Wheat and Spoon Size Shredded Wheat (CX 430 C - Tables, p. "C-Nabisco," received into evidence as GFX 1319).

22. Nabisco purchased Ranger Joe Cereal Company, which had been a regional producer of presweetened puffed wheat and rice, in the mid-1950's (Tr. 26,494–95; CX–GF 167Z–11).

23. Nabisco's share of the RTE cereal market, based on pound sales, was 9.3% in 1950 and approximately 4.8% in 1970; on a dollar sales basis, these market shares were 6.6% and 3.7%, respectively (CX 106A–G).

F. *Ralston*

24. Ralston was incorporated in Missouri in 1894 and is headquartered in St. Louis, Missouri. It manufactures and sells, among other things, RTE cereals, pet foods, tuna fish, and snack foods (Tr. 3739, 3839, 8190).

25. Ralston produces RTE cereals in Battle Creek, Michigan; Cincinnati, Ohio; and Lancaster, Ohio (Tr. 3531, 3572, 10,722). It sells under the Ralston name and under private label (Tr. 3839–40, 8213, 17,506–08). Ralston's share of the RTE cereal market, based on branded pound sales, grew from approximately 3.0% in 1950–1951 to approximately 5.0% in 1960. It declined to approximately 3.8% in 1970. If Ralston's private label sales were included, its market share would be somewhat greater (CX 106A–G).

G. *Other Companies*

26. Over the years, there have been a number of manufacturers of RTE cereals. It has been estimated that in 1911, there were over 100 brands of corn flakes being packed in the Battle Creek, Michigan area alone (GFX 1370G). [36]

27. In 1965, the National Commission on Food Marketing sur-

veyed 58 cereal producers in preparing its study of this category. Twenty-four of these producers had sales of $200,000 or more (GFX 1370G).

28. For example, Van Brode Milling Co. manufactured corn flakes and crisp rice and private label cereals dating back to the 1940's (Tr. 12,136, 13,717, 36,316). Jersey Cereal Company produced a number of RTE cereals, including corn flakes, wheat flakes, bran flakes, rice flakes, rice gems, wheat puffs, and rice puffs under its own name as well as private labels. Jersey's net sales were $2.7 million in 1942 (GFX 253F).

29. Colgate-Palmolive marketed Weetabix, a shredded wheat, and Alpen, a natural cereal (Tr. 12,573–75, 26,492). Carnation acquired the Albers Milling Company, an early manufacturer of corn flakes, and began to market the product as Carnation Corn Flakes. Carnation quit the business in 1963 (Tr. 11,752, 12,911, 26,334). Pillsbury was manufacturing a granola by 1972 (Tr. 12,914).

30. Specialty Brands, early in 1973, acquired the Vita Crunch Foods, Inc., which produced a granola-type cereal. By 1975, this company's sales amounted to about $5 million (Tr. 25,916–18).

31. Organic Milling Company entered the RTE cereal business in 1971 with a granola product and, by 1975, sales had reached $1 million. Organic Milling Company acquired the Vita Crunch label in 1975 and, in 1977, earned annual revenues in excess of $2 million (Tr. 37,295, 37,298).

32. The H.J. Heinz Company entered the RTE cereal business in the 1930's and produced a rice flakes product until some time prior to the late 1950's (Tr. 12,992, 26,334).

33. International Multifoods Corporation acquired the Kretchmer Wheat Germ Company and subsequently manufactured a natural cereal (Tr. 30,039). The company also manufactured a granola, Sun Country Granola (Tr. 26,487).

34. Pet, Inc., by 1972, had sold various types of granolas, including Heartland, and two presweetened cereals (Tr. 12,916, 12,998).

II. THE RELEVANT MARKET

A. *Relevant Product Market*

The standards set out in *Brown Shoe Co.* v. *United States,* 370 U.S. 294 (1962) (a Section 7 Clayton Act case), by which relevant product markets and submarkets are determined are also applicable to a case involving charges of monopolization and restraint of trade. [37]

United States v. *Grinnell Corp.*, 384 U.S. 563, 573 (1966); *Borden, Inc.*, 92 F.T.C. 669, 782–84 (1978).[11] As stated in *Brown Shoe:*

> The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States* v. *E.I. duPont de Nemours & Co.*, 353 U.S. 586, 593–595. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors (at 325, footnotes omitted).

1. *Recognition By The Major RTE Cereal Producers, Including Respondents, Of The RTE Cereal Market As A Distinct Product Market*

35. In a 1969 "[o]rientation presentation for people outside the Company telling about the Kellogg Company" (CX–K 746A), "The Ready-To-Eat Cereal Industry" comprises a separate section. Highlights in this section include "the growth in pound volume of this industry" and Kellogg's share of the RTE cereal "market" (CX–K 746G). Another Kellogg product, Pop Tarts, is discussed under a separate section entitled "Toaster Pastry Market" (CX–K 746H).

36. Speeches by Kellogg executives clearly reflect Kellogg's view that RTE cereals is a distinct product market (CX–K 549K, M, 559C), exclusive of products such as Pop Tarts and hot cereals (CX–K 549D, 559D). Kellogg's marketing plans for its RTE cereals [38]also contain numerous references to the "RTE cereal market" (CX–K 7176A, 7177A, 7178B, 7179A).

37. General Foods' marketing plans also consistently refer to "the RTE cereal market" in their analyses of particular RTE cereal brands and groups of brands (CX–GF 1300B, F, 1303A). Several General Foods marketing plans used the following formats which specifically outlined RTE cereal as the relevant market for analysis:

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[11] Respondents assert that the Commission's ruling in *Borden* is incorrect and reflects a misreading of *Grinnell*. The Commission's ruling is not a mere passing reference to language in *Grinnell*, but constitutes a studied consideration of the question. It, therefore, constitutes a controlling precedent covering my determination of relevant product market.

I. Total Industry

A. Total Market Trend
During Fiscal '67, the total RTE pound cereal market . . .

(CX–GF 602Q);

I. Market Climate

A. Market Profile

1. *Volume.* Ready-to-eat cereal market pound volume . . .

(CX–GF 1300B).

38. Similarly, General Mills' marketing plans contain references to the "RTE cereal market" (CX–GM 600A; GMX 106A). The marketing plan for the product Lucky Charms, for example, refers to the "Total RTE Market" when discussing "Cereal Market Trends" (CX–GM 2176B).

39. When Quaker purchased and used Nielsen data for sales forecasts for RTE cereals, the information was on the basis of the total market, the presweetened market and the nutritional market, and it looked essentially at those two segments within the total market. This is the format in which this Nielsen data was ordered by Quaker (Tr. 14,969–70). The respondents similarly purchased reports from Nielson and other survey service companies which included data on RTE cereal sales (See, *infra,* Findings 153, 154).

40. The marketing plans of the major producers of RTE cereals also divide the total RTE cereal market into sub-segments. Kellogg recognized "the presweetened segment of the R–T–E Cereal market" (CX–K 397A). A Kellogg marketing plan stated that its new presweetened RTE cereal product Kombos "will not only add to . . . [its] overall sales volume, but will, in addition, protect and increase . . . [its] dominance in an important segment of the RTE cereal business" (Tr. 11,689; CX–K 9031A). General Foods noted that "[t]he bran category (excluding raisin brans) continues to decline in importance to the total R–T–E market" (CX–GF 1302A). General Mills' analyses of "Cereal Market Trends" in its marketing plans include graphic presentations which show and plot "Total RTE Market" pound sales over **[39]**time, with a "Pre-Sweet Market" pound sales line juxtaposed on the same graph (CX–GM 2176B, 2178B, 2185B). A Quaker marketing plan states: "[T]his project [Quisp and Quake] is another major effort on the part of Quaker to establish its position in the pre-sweetened segment of the RTE market" (CX–Q 153B). Several Quaker marketing plans included the following format for market analyses:

I. Analysis

A. Market Trends

1. Total RTE pound sales . . .

2. Total RTE dollar sales . . .

(CX–Q 164B, 167C, 2496B, 2497B, 2630B).

41. Kellogg, General Foods, and Quaker projected and evaluated market shares for particular RTE cereal brands in relationship to the total RTE cereal market (Tr. 11,724, 12,133, 12,150, 13,054, 14,969, 36,397).

42. Both Kellogg and General Mills endeavored to secure shelf space for their RTE cereals at least equivalent to the share their sales bore to the total market sales of RTE cereals (Tr. 7103, 8022–23). Kellogg's magna board, which was used as part of its shelf space program, made no space accommodations for instant breakfast or toaster pastry products (Tr. 8965), and Kellogg's recommendations included the replacement of instant breakfast from the RTE cereal shelf section to the hot cereal section (Tr. 8915).

43. Major producers of RTE cereals viewed only other RTE cereal products and the firms producing those products as competitors in the RTE cereal industry. These producers examined other RTE cereal products to learn about the competitive environment of which their RTE cereals were a part. Industry witnesses testified that the companies with which they compete are other RTE cereal manufacturers (Tr. 7521, 11,374, 14,717, 17,173–77, 18,015; CX–K 549F, G, H).

44. Kellogg, the largest factor in the RTE cereal industry, did not consider other breakfast foods as being in the same market. Pop Tarts, generally known as toaster pastries, were viewed as constituting a separate market of convenience bakery products (CX–K 129, 260C, 549D, 740F, 746H). The advent of new products known as instant breakfast drinks did not cause Kellogg to make any changes in its advertising policies, promotional strategies, or pricing policies with respect to Kellogg's RTE cereal products. Neither did the introduction of toaster pastry products cause Kellogg to make any adjustments or changes in its promotional strategies or pricing decisions regarding RTE cereals (Tr. 11,558–60). **[40]**

45. Kellogg wants instant breakfast drinks to be placed in the milk fortifier section of supermarkets, along with such products as Nestles Quick, Ovaltine and Bosco (Tr. 12,702). Kellogg's position is that a separate market exists for instant breakfast drinks, apart from the cereal market:

Instant Breakfast drink is not a cereal! It is a milk fortifier, comparable to:

Ovaltine
Homo
Bosco
Hershey's Milk Amplifier
Nestles Quick
Ghiradelli's Flick (CX–K 7172B).

"Instant Breakfast" drink is not a cereal. It was reportedly designed to appeal to people who do not eat breakfast. (Cereal customers eat breakfast so it does not belong in that department.)
More than 78% of the population drink coffee. To reach breakfast skippers (especially the "coffee only" kind), place "instant breakfast" drinks in the "Coffee, Tea, and Cocoa" department (CX–K 7172D).

46. Ready-to-eat and hot cereals are two separate types or categories of cereals (Tr. 6558, 9095). This distinction was recognized by a Kellogg official in a marketing strategy address at a sales meeting in November 1960:

I think we can safely say that the ready-to-eat cereal industry has done a better selling job than the hot cereals (CX–K 559D).

And Kellogg separately disseminated market share data on cereals to be cooked (Tr. 12,133).

47. The Cereal Institute is a trade association, with membership limited to all producers of RTE and hot cereals (Tr. 11,866–67, 15,333). While producers of hot cereals were members, in part, for the purpose of funding research into the effects of eating cereals of any kind for breakfast (Tr. 15,333), hot cereals clearly do not belong in the RTE cereal industry. RTE cereals are a revolutionary departure from a cooked cereal (Tr. 29,585). Jewel Food Stores, for [41]example, treated hot cereals as a separate category from RTE cereals and shelved hot cereals after RTE cereals along with instant breakfast and toaster pastries (Tr. 9095). As developed throughout this section of the initial decision covering relevant product market, hot cereals are not a part of the recognized RTE cereal market. They have no impact on the pricing of RTE cereals, they do not qualify as the convenience food which characterizes RTE cereals, but require cooking or heating, and are not produced on RTE cereal type of equipment. Indeed, Kellogg, the largest producer of RTE cereals, has never produced a cooked cereal (Tr. 12,134). The following RTE cereal manufacturers are members of the Cereal Institute:

Kellogg Company
General Foods Corporation
General Mills, Inc.
The Quaker Oats Company

Ralston Purina Company
National Biscuit Company
Malt-O-Meal Company
Van Brode Milling Company, Inc.

(CX–CI 59A; Tr. 11,866–67)

2. *Distinct Prices Of RTE Cereal And Insensitivity To Prices Of Other Products*

48. When establishing prices for RTE cereal products, Kellogg considered the prices of competitive RTE cereal products (Tr. 11,564–65, 11,647, 11,736, 12,927–28). General Mills and General Foods also set their RTE cereal prices to be responsive to, or competitive with, those of their major RTE cereal competitors and their particular competitive brands (Tr. 14,208–09, 14,235, 36,403; CX–GM 110A; CX–GF 17L, 485Z–107, 601F, 1382U, 1410L). In pricing Wheaties, for example, General Mills considered primarily all-family cereals and, to a lesser extent, children or adult cereals (Tr. 35,527).

49. The introduction of instant breakfast drinks and toaster pastry products caused no changes in the pricing, promotion, or advertising of Kellogg's RTE cereals (Tr. 11,558–60, 12,497). Kellogg never instituted a trade deal on an RTE cereal product in response to a trade deal on toaster pastry products (Tr. 12,535). Representative chain store executives testified that, in pricing RTE cereals, retailers would not consider the prices of instant breakfast drinks, toaster pastry products, eggs, or any other products (Tr. 9003, 9132, 9347).

50. For the period 1960–1972, the actual cost per serving of an RTE cereal ranged from two cents to six cents, and an additional four [42]to five cents for milk (Tr. 17,682, 30,044–45). Carnation's Instant Breakfast cost substantially more—13 cents per serving for the product itself, and 25 cents additional for the milk that is required (Tr. 17,683, 30,044–45; CX–K 9B, 11A). A bacon and egg breakfast is materially higher in price than a bowl of cereal and milk to the extent of there being dollar differentials (Tr. 17,098–99, 17,682–83). Pop Tarts cost more than RTE cereals on a cost per serving basis (Tr. 12,213). RTE cereals are more convenient and less expensive, on a per serving basis, than toaster pastries, frozen waffles and frozen pancakes, and have an economic advantage over such products (Tr. 30,042). While hot cereals are sold at lower prices than RTE cereals, this has not resulted in an increased sale of hot cereals at the expense of RTE cereals (Tr. 30,051).

3. *RTE Cereals' Peculiar Characteristics And Uses*

51. RTE cereals have grain as a basic ingredient, and are ready to be consumed as purchased without further preparation (Tr. 12,142). They are processed from corn, wheat, oats, rice or bran, and combinations or blends thereof (CX–K 698; CX–GM 736), and are then either flaked, puffed, granulated, extruded, or shredded (Tr. 7524, 10,723, 13,405; CX–GM 736). RTE cereals contain sugar and vitamin additives and some are processed in a flavored syrup (Tr. 10,723–25, 11,482, 11,786, 11,806). These are a unique combination of characteristics.

52. Unlike many other breakfast products, RTE cereal products require little preparation prior to consumption. In fact, preparation requirements are so minimal that a child can easily prepare his or her own RTE cereal. The consumer adds only cold milk, and sugar if desired (Tr. 11,796–97, 11,858–60, 12,426, 12,996, 30,041–42). The consumer does not cook or heat the product, nor is boiled water or any other cooked substance added to an RTE cereal prior to its being consumed (Tr. 11,753). Such ease of preparation is a significant and distinguishing characteristic of RTE cereals, just as its name "ready-to-eat" describes (Tr. 12,923).

53. Most other foods consumed at breakfast require more than minimal preparation. Bacon and eggs must be cooked prior to being eaten. Hot cereals lack the convenience and ease of RTE cereal products, requiring cooking or the addition of boiling water prior to consumption (Tr. 13,220). Producers of toaster pastries and frozen breakfast products recommend that these products be toasted or warmed before being eaten (Tr. 30,043).

54. RTE cereal products are packaged for easy storage in moisture-resistant boxes or bags normally containing half a dozen or more servings, and they can be stored or shelved for relatively long periods of time, often for as long as nine to twelve months (Tr. 6664, 17,569). This is in contrast to many other breakfast **[43]**foods which must be kept refrigerated or frozen, and to some which may be stored only for short periods of time. Frozen pancakes, frozen waffles, and frozen french toast, as their names imply, must be frozen; bacon and eggs must be refrigerated. Perishable products, such as bacon and eggs, must be used within a short time.

55. RTE cereals are designed to be a nutritional breakfast which can be eaten from a bowl. Many cereal eaters prefer eating their breakfast instead of drinking it from a glass, as is done when consuming instant breakfast. Buc Wheats, for example, was introduced by General Mills to provide the nutrition of a bacon and egg

breakfast for the many consumers who wanted this nutrition in the convenient form of a cereal (Tr. 17,714–18, 30,041–42).

56. Unlike other food products, RTE cereals are consumed predominantly at breakfast (Tr. 12,142, 14,224–25). Instant breakfast drinks, on the other hand, are viewed by Kellogg as "quick energy snacks" which are consumed anytime throughout the day, particularly between meals, at lunch, and before bedtime. Furthermore, instant breakfast drinks were designed for breakfast "skippers" (CX–K 7172D).

4. *RTE Cereals' Unique Production Facilities*

57. RTE cereal products are manufactured by a number of basic high volume processes which are unlike those used for the production of other breakfast foods. The processing includes such steps as cooking, pelleting, drying, flaking, puffing, extruding, toasting, and coating. Bacon and eggs, for example, are not "produced" with manufacturing equipment. Cereal production equipment, on occasion, has been used to manufacture non-cereal products such as Whistles and Bugles, which are marketed by General Mills as snack foods (CX–GM 736, 2018A, 2019D, 2020D). It is significant that Kellogg, the largest producer of RTE cereals, has never produced a cooked cereal (Tr. 12,134).

58. It is clear, therefore, that the major RTE cereal producers recognize the RTE cereal industry as a distinct market, with certain submarkets, and plan, compete and conduct their RTE cereal business on that premise; that the prices of RTE cereals are distinct from those of other breakfast foods and are insensitive to the prices of such other products; that RTE cereals have peculiar characteristics and uses and are manufactured on unique production facilities. Under the criteria enunciated in *Brown Shoe* v. *United States,* 370 U.S. 294, 325 (1962), it must be concluded that RTE cereals constitute the relevant product market. [44]

B. *Segments Of The RTE Cereal Industry*

59. While RTE cereals constitute the relevant product market, all RTE cereals do not compete to an equal degree with each other. There are segments or categories of cereals which compete more strongly with each other because of their similar attributes. There are some cereals that are so similar that they compete with each other on a one to one basis. At the same time, some cereals may have a broader appeal than the particular segment or category they may

fall in so that they compete to varying degrees with cereals outside of their particular category.

60. The record does not permit an exact delineation of the segments and of the relative degree of competition within and among segments and individual cereals. It does, however, support the finding that there are such segments and such primary and varying degrees of competition.

61. General foods, for example, when looking for new product opportunities, recognized that competition among brands is, to a degree, segmented or localized (Tr. 14,192–93, 14,407–16, 14,497–500).

62. Some brands are more directly competitive with one another than with other cereals (Tr. 7563–71). New brands mostly affect the sales of other cereals in the same category or segment. For example, if a new cereal is "very close " to a General Foods brand in meeting some of the same consumer wants, some consumers of the General Foods brand would likely try the new brand (Tr. 14,088–89, 14,220–27). Sometimes there could be an alternative direct choice to a particular General Foods brand (Tr. 13,537–40). While the introduction of a new RTE cereal would have some effect on the sales of all other RTE cereals, it would have more effect on those products in the same segment, and the most effect on products with which the new product is most closely competitive (Tr. 15,222, 15,754–55).

63. The greater the difference between an existing brand and a new brand, the less the impact from the introduction of the new brand. For example, the introduction of a new chocolate flavored presweet would have greater impact on on existing chocolate flavored presweets than on fruit flavored presweets (Tr. 14,966).

64. Kellogg, when pricing its new RTE cereals, considered the pricing of brands with which its new brand would compete most directly. Kellogg planned to sell its new cereals at prices comparable to those charged for these most directly competing brands (Tr. 11,564–65, 13,200–01). Kellogg generally identified areas of opportunity for new brands by looking at the sales growth of particular brands in particular market areas (Tr. 12,832–33). It estimated sales for its new brands, in part, on the particular brands the new brand would have to compete with. Kellogg looked at the brands the new brand was tested against. The sales estimates assumed that the new brand would be priced "competitively" in relation to those brands it might compete most directly against (Tr. 12,876–79). [45]

65. In pricing each established brand, Kellogg gave special consideration to the prices of the brands that the Kellogg brand competed with most directly. Relatively few brands were considered

as the directly competitive brands for each Kellogg brand (Tr. 30,056–59; CX–K 130C–D).

66. A Kellogg marketing plan for seven Kellogg cereals indicates that certain new brands are "direct competition" for the Kellogg products, while other new brands are "indirect competition." The new directly competitive brands were deemed to have affected the sales of the Kellogg products (CX–K 397C).

67. In determing whether to use an in-pack premium with a particular brand, Kellogg considered what its competitors were doing on a comparable product (Tr. 12,321).

68. General Foods expected its new brand introductions to take some sales from directly competitive brands in the new brand's category, such as all-family, unsweetened or adult (Tr. 8824–25).

69. General Foods believed that if it introduced brands similar to ones it already had on the market, they would take a fair share of sales from those similar brands; that if it introduced brands dissimilar to ones it already had on the market, they would take fewer sales from its own brands (Tr. 14,198–99).

70. General Mills sales personnel recognize that certain RTE cereal brands are more directly competitive with one another than with others (Tr. 7698–99, 7709–12).

71. While there is not complete agreement among respondents and other RTE cereal producers (or their representatives) as to the demarcation of the segments and as to which brands are in most direct competition, the following brand categories and individual brand competitors have been recognized by them to the extent indicated:

1. *Corn Flakes*

72. Kellogg sees its Kellogg's Corn Flakes as most closely competitive with other corn flakes, including Post Toasties, General Mills' Country Corn Flakes and private label corn flakes (Tr. 7565–66; CX–K 7181I). Kellogg compares the retail pricing of the corn flakes brands (CX–K 130C, 663).

73. In pricing, General Foods has regarded Post Toasties as directly competitive with Kellogg's Corn Flakes, and chose not to change Post Toasties' price in the absence of a price change by Kellogg (Tr. 13,983–84; CX–GF 418D, 485Z–107, 2024C). General Foods decided that its Post Toasties and Kellogg's Corn Flakes should sell **[46]**at identical prices for the same size packages (Tr. 14,235). General Mills recognized that consumers perceived its Country Corn Flakes as nothing more than another corn flake (Tr.

17,634, 17,750). Country Corn Flakes, Kellogg's Corn Flakes, and Post Toasties are direct alternative choices to the consumer (Tr. 13,538–40).

2. *Wheat Flakes*

74. The RTE cereal manufacturers have seen other wheat flakes as the most direct competitors to their own. Kellogg sees the direct competitors for its Pep as General Mills' Wheaties and Post's Grape Nuts Flakes (CX–K 684, 758C).

75. Mr. Schulze, a top marketing official of General Mills, felt that its Wheaties' primary competition was Kellogg's Corn Flakes, but that Wheaties' pricing was in parity with Kellogg's Pep and General Foods' Grape Nuts Flakes (CX–GM 280). He testified that Wheaties' most direct competitors were Kellogg's Corn Flakes, Pep, and Team Flakes (Tr. 17,188–89). A General Mills analysis of a proposed Wheaties price change compared its prices to those of its "major flake competitors," Post Toasties, Kellogg's Corn Flakes, Grape Nuts Flakes, and Cheerios (CX–GM 287B). A General Mills marketing plan listed General Mills' Cheerios and Kellogg's Corn Flakes, Rice Krispies and Special K as Wheaties' "4 Direct Competitors" (CX–GM 2181B).

76. General Mills conducted a "switching" analysis study on a test product called Frosted Wheaties that showed a high rate of switching between the test product and regular Wheaties. General Mills, therefore, decided not to market Frosted Wheaties (Tr. 15,830, 16,191–92).

77. General Foods' strategy was to maintain the same retail price on Grape Nuts Flakes that was charged on Wheaties (CX–GF 418D).

3. *Variety Packages*

78. Kellogg saw variety packages as direct competitors of each other. Kellogg compared the retail prices of its tray pack to those of Post and of Kellogg's Variety to Post's Tens (CX–K 118E, 130C). If Kellogg were introducing a new variety package, it would look at the price of the competing variety packages already on the market (Tr. 11,564). **[47]**

4. *Rice Krispies, OK's, Alpha-Bits And Cheerios*

79. At times, the RTE cereal producers have compared Kellogg's Rice Krispies, Kellogg's OK's, General Foods' Alpha-Bits, and General Mills' Cheerios as directly competing brands.

80. Kellogg believed that Rice Krispies competed more with Cheerios than with other cereals. Thus, in pricing Rice Krispies, Kellogg was "conscious of the price of Cheerios" (Tr. 30,114–15). Kellogg, in its marketing strategy for Rice Krispies, noted that its sales force had made an effort to bring Rice Krispies' retail pricing in line with Cheerios, and that this effort resulted in share and volume increases for Rice Krispies. Kellogg's marketing personnel frequently compared the retail price of Rice Krispies with that of Cheerios (CX–K 125B, 126B–C, 130C, 131A, 135B; 7179B). General Mills also compared these two brands. In pricing its Cheerios, General Mills originally concluded that Kellogg's Corn Flakes and Rice Krispies were Cheerios' only "major competitive products" (CX–GM 278A). Subsequently, General Mills added Kellogg's Sugar Frosted Flakes to Cheerios' "principal competition" (CX–GM 563Z–5, Z–22, 2167A).

81. Kellogg recognizes that its OK's competes in the same area of the market as Cheerios. It identified General Mills' Cheerios, an established oat cereal, as being in a growing area of the market, thus offering an opportunity for a new Kellogg brand. The sales success of Cheerios was the principal reason Kellogg developed OK's (Tr. 11,267–68, 12,832–33). Kellogg sees Cheerios as OK's biggest single oat competition (CX–K 563C–E).[12] Kellogg's objective for OK's was to establish it in the oat area of the market, occupied exclusively by Cheerios until Alpha-Bits and Life were introduced (CX–K 396A). Kellogg expected that the most important source of OK's sales would be Cheerios and Alpha-Bits consumers switching brands. The next most important source would be other kid oriented cereal consumers; then, consumers of all other cereals (CX–K 396A).

82. General Foods introduced Alpha-Bits in recognition of the opportunity to introduce a new brand in this shaped dough area of the market. Consumers had shown a liking for the expanded, dough-based Cheerios. General Foods determined that some variety in flavor, texture and form might support a new brand in this area. That was the genesis of Alpha-Bits, which included other letters of the alphabet in addition to the Cheerios' "O" (Tr. 13,413–18). **[48]**

5. *Nutritional Cereals*

83. Nutritional cereals compete more closely with each other than with other cereals. Even among the nutritional cereals, some cereals compete more directly than do others.

84. Kellogg's advertising agency considered Quaker's Life and

[12] Cheerios and OK's are primarily oats with some differences. Cheerios is entirely composed of O's; OK's had some O's and K's. Later, the K's were removed (Tr. 7560, 29,651).

General Mills' Total to be potent competition for Kellogg's Special K, with Total a roadblock to further Special K sales increases. It considered Special K and Total to be in a "head-on-battle," with Special K losing volume to Total (CX–K 7355A). In 1965, the agency reported to Kellogg that "products directly competitive in nutritional appeal to Special K are: Total, Life, Kellogg's Concentrate, General Foods' Grape Nuts and National Biscuit Company's Team;" and that Total was a threat to Special K (CX–K 7353F).

85. The agency reported to Kellogg a "need for a related product [to Special K], specifically the need for a strong Kellogg contender in the nutritional cereal market that can combat the nutritional claims of Total" (CX–K 7353H). The sales growth of Special K and Total in the nutritional segment led Kellogg to identify that segment as presenting an opportunity for profit from yet another brand. Kellogg, therefore, developed Product 19, a similar product (Tr. 12,396–98, 12,839–40).

86. Kellogg identified two important subsegments of the nutritional market segment—the protein segment, toward which Special K was aimed, and the vitamin segment, toward which Product 19 would be aimed. Other products in the protein segment were Life and Concentrate. The only other product in the vitamin segment before Product 19 was General Mills' Total. The most important requirement for Product 19 was to compete in the Total market (Tr. 13,006; CX–K 466).

87. Most new products are targeted at those people expected to be most interested in the product. Advertising is then developed to appeal to those people. Product 19's advertising was aimed at those 35 years of age and older. Kellogg directed its marketing plan toward the same audience as that served by General Mills' Total (Tr. 11,483, 12,398–403; CX–K 7176H).

88. There were six logical direct competitors of Product 19: Special K, Concentrate, Nabisco's Team Flakes, Total, Corn Total, Life—the nutritional cereals (Tr. 7563–64).

89. Kellogg's marketing plan for Special K compared the retail prices of the six other cereals in the "nutritional category" to that of Special K. Kellogg noted that the prices of Total and Product 19 "remain very competitive." In addition, the new presweetened cereals with vitamins, such as King Vitaman, "represent indirect . . . competition" (CX–K 7184K). Within the grouping of the seven [49]nutritional cereals, two were considered as most directly competitive: Total and Product 19 (Tr. 11,483, 12,398–403; CX–K 7176A–M).

90. Kellogg considered taking competitive moves with respect to its nutritional brands if Nabisco's Team Flakes continued to improve

its sales. It also noted that General Mills had responded to Product 19 by increasing Total's iron fortification level. General Mills' advertising campaign on Total included an assertion that it was a "calorie controlled breakfast," following Special K's primary claim for being a "calorie-controlled, complete breakfast" (CX–K 7180E).

91. "Since its introduction, the overall marketing strategy for Product 19 has been to place the brand in direct competition with General Mills' Total." Kellogg recognized that Product 19's most readily identifiable competition has come from within the nutritional category. The other cereals in that category are Total, Special K, Post Fortified Oat Flakes, Life, Grape Nuts, and Nabisco's Team Flakes. Total has traditionally been Product 19's primary competitor. Kellogg compared advertising and pricing among these seven cereals (CX–K 607, 674, 7176A, E, F, G).

92. Kellogg's product manager for Special K recommended a coupon on Special K to combat General Mills' use of a promotional insert with Total and Post's Grape Nuts' sales growth (CX–K 649). Kellogg compared the retail prices of Product 19 and Special K to Total to determine whether they maintained their proper relationships (CX–K 125B, 130C).

93. In analyzing the consumption of "health cereals," General Mills concluded that consumers were more likely to switch their purchases among Total, Special K, Product 19, and Fortified Oat Flakes (CX–GM 128C, 570B). The nutritional category, according to General Mills, included these cereals plus Life and Grape Nuts (Tr. 7699, 7710; CX–GM 597F, G). Among these cereals, the most nearly competitive were considered to be Total, Special K, and Product 19 (Tr. 15,746–47; CX–GM 174, 280). General Mills responded to the introduction of Total's "direct competitor," Product 19, by increasing the fortification of Total (CX–GM 567).

94. From 1966 to 1970, General Mills believed that Kellogg's Product 19 competed more directly with General Mills' Total than it did with other RTE cereals. Mr. Schulze of General Mills was concerned that the introduction of Product 19 would have an adverse effect on the sales of Total, which it did (Tr. 17,196–203). General Mills' product manager and assistant product managers for Total thought that the introduction of Product 19 adversely affected Total's rate of sales growth (Tr. 17,236).

95. General Mills thought Kellogg's Product 19 and Special K and Quaker's Life would likely have the greatest impact on the sales of its Total. General Mills considered Product 19 a "direct competitor" to Total. Special K was said to be "more directly competitive

with Total" after Kellogg increased the fortification level of Special K (CX–GM 564C). **[50]**

96. Product 19's introduction in Kellogg's Sperry Zone (Western United States) adversely affected Total's market share in that area (CX–GM 570J, L). General Mills undertook "defensive activity" to blunt the inroads of Product 19 on Total's sales (Tr. 17,231–37; CX–GM 570N).

97. While General Mills felt that Product 19 had taken sales from brands other than Total, its impact was felt in lost Total sales (CX–GM 69B, 567A, 570Z–13, 601G, I). General Mills expected increased pressure on Total's sales from other brands to be introduced in the health cereal category, which included Total, Product 19, Special K, Fortified Oat Flakes, and Life (CX–GM 69C, 570Z–13–14). General Mills' strategy for Total was to "stave off inroads made by Product 19" (CX–GM 570Z–15).

98. In determining its introductory price for Buc Wheats, General Mills considered the prices of Total, Product 19, and Special K. It wanted to make sure that Buc Wheats' pricing was reasonably competitive with those products (Tr. 17,297, 17,284; CX–GM 592Q, 593U, Z–16, 599S, V).

99. General Mills' marketing personnel concluded that bran and health categories differed. General Mills expected Vital 7, a fortified bran product, to compete in the health category, although it might compete with bran products as well. General Mills expected Vital 7 to compete with other 100% minimum daily vitamin requirement products such as Total and Product 19, but not necessarily with Special K, which was considered quite different (Tr. 17,261).

100. In January 1968, a General Foods consumer study concluded that "three brands form the basic nutrition[al] cereal category—Total, Life, [and] Special K—with other brands used substantially less frequently for [their more] specific nutritional attributes" (CX–GF 1348Z–204). A second consumer survey found that the nutritional cereal category included Special K, Total, Product 19, and Grape Nuts (CX–GF 1403O, Q). General Foods considered the prices of Special K, Total, and Life when it priced Grape Nuts (CX–GF 485Z–85).

101. General Foods' market research group explored how large an opportunity there was for a particular new brand by looking at the brand's characteristics, the strength of its consumer appeal, the size of the potential consumer group, the other brands that could satisfy those consumers in the same general market segment, and how those other brands were performing (Tr. 14,188–89).

102. When General Foods introduced Fortified Oat Flakes, it

concluded that its "direct competition" was Special K, Product 19, Total, and Life (CX–GF 1406G). In exploring how large the opportunity was for Post's Oat Flakes, General Foods looked at the market segment comprised of the cereals whose primary attribute was nutrition. Those cereals included Grape Nuts, Special K and the wheat based cereals (Tr. 14,188–89). Kellogg's introduction of Concentrate, marketed as a nutritional cereal, was closely watched by [51]General Foods because of the likely effect on its Oat Flakes (Tr. 14,220–27).

103. Quaker priced its Life cereal to maintain a "spread relationship" with "its principal competition—Special K and Total" (CX–Q 46E, H; 47E).

6. *Raisin Brans*

104. Raisin bran cereals constitute a recognized cluster of cereals that compete more closely with each other than with other brands (Tr. 7565). In marketing Kellogg's Raisin Bran, Kellogg gives special consideration to Post's Raisin Bran advertising (CX–K 7177A–B, D, H, I). Kellogg compares the retail prices of the Post and Kellogg raisin brans (CX–K 130C, 663). A Kellogg analysis of its Raisin Bran business considered only Post's Raisin Bran in addition to its own (CX–K 439).

105. In addition to comparing raisin brans, Kellogg also considered some less direct relationships between raisin brans and other cereals. For example, in preparing its marketing strategy for Kellogg's Raisin Bran, Kellogg also watched Post's Bran/Prune Flakes and Ralston's Bran Chex with Raisins. Kellogg also noted the demise of General Mills' Bran with Raisin Flavored Flakes (Tr. 7565; CX–K 7177A–B, D, H–I).

106. When General Foods priced its raisin bran, it compared only Kellogg's Raisin Bran prices (CX–GF 439C, 440J, 2000R). It viewed Kellogg's Raisin Bran as Post Raisin Bran's "major (and virtually only) competitor" (Tr. 13,537–40; CX–GF, 440F, 485Z–120). General Foods believed that the two raisin brans should sell at identical prices (Tr. 14,235).

107. General Mills, with its Wheaties Bran with Raisin Flakes, attempted to get some of the growing business that was being obtained by the competitive raisin bran products (Tr. 17,995).

7. *Whole Bran*

108. Kellogg developed Bran Buds in recognition of the opportunity for a new brand in the growing segment of whole bran products,

consisting of Kellogg's All Bran and Nabisco's 100% Bran (Tr. 12,844). Kellogg compared Bran Buds with Nabisco's 100% Bran in terms of consumer preferences. Bran Buds was designed to protect Kellogg's position in the whole bran category, while blocking the sales growth of Nabisco's 100% Bran. Kellogg introduced Bran Buds to work with All Bran to "bracket competition." Kellogg expected Kellogg's All Bran and Bran Buds and Nabisco's 100% Bran to be close competitors (CX–K 409B, 566, 605, 686). **[52]**

109. It is not likely that a bran product would compete with a presweet flavored product such as Apple Jacks. If there were any competition, it would be very small (Tr. 12,880).

8. *40% Brans*

110. The 40% bran cereals constitute a recognized cluster of brands that compete more closely with each other than with other brands. General Foods believed that its Post Bran Flakes "competes most directly with the Bran segment of the RTE cereal market . . . composed of Bran Flakes and Whole Bran products, excluding Raisin Bran" (CX–GF 1990C); that within that grouping, Post's Bran Flakes are "directly competitive" with Kellogg's 40% Bran Flakes (CX–GF 485Z–23). General Foods tried to price its Bran Flakes to match Kellogg's 40% Bran Flakes (Tr. 14,235; CX–GF 418D, 1989B, 1991H). Kellogg compares the retail prices of Post 40% Bran Flakes and Kellogg's 40% Bran Flakes (CX–K 87B, 122B, 127A).

111. General Mills' marketing people believed that the bran market might support another product. General Mills did a simulated sales test, mailing a package flat to a representative sample of bran consumers to determine if they were interested in buying General Mills' new product, Alive (Tr. 15,797–99).

9. *Shredded Wheat*

112. The shredded wheat segment includes cereals perceived by consumers as meeting similar desires of taste and texture—Quaker Muffets, Quaker Shredded Wheat, Nabisco Shredded Wheat and Sunshine Shredded Wheat (Tr. 15,289). Within the shredded wheat segment, brands were divided into whole biscuit and spoon-sized products (Tr. 15,289–92).

113. Quaker priced its Shredded Wheat relative to Nabisco's Shredded Wheat (Tr. 15,289–301).

114. Kellogg placed its Mini-Wheats in the "Shredded Wheat market" where it would appeal first to consumers of shredded wheat products. Other products deemed by it to be in this area of the

market were Nabisco's regular and spoon-sized shredded wheats, Ralston's Wheat Chex and General Mills' Wheat Stax. Mini-Wheats was expected to take sales away from other shredded wheat competitors (CX–K 573C–G, 679). Nabisco's Sweet Wheats was seen as a close competitor to Mini-Wheats. Kellogg reasoned that to cut into Nabisco's Shredded Wheat sales significantly will require a "more directly competitive product—an unsweetened" Mini-Wheats (CX–K 7201E). In determining the introductory advertising for its Mini-Wheats, Kellogg considered the introductory advertising **[53]** expenditures for the most recent brand introductions in the shredded wheat category (Tr. 13,096). However, Mini-Wheats was sufficiently differentiated from other shredded wheat products that consumers of Mini-Wheats, over 60% of whom came from purchasers of regular shredded wheats, did not make price comparisons with the regular shredded wheats (CX–K 529A).

115. Kellogg attributed declines in the sales of Kellogg and Nabisco shredded wheat to the success of Sunshine Shredded Wheat (CX–K 647).

116. Kellogg's Krumbles was considered by Kellogg to be a part of the Wheat Shreds market, consisting of six other shredded wheat brands. Krumbles was the only one not in biscuit shape (CX–K 680A, C).

10. *Presweets*

117. Kellogg regarded particular products as representing narrower areas or subsegments within the presweetened segment. It sought to develop products to compete more directly with particular presweet products, such as Cap'n Crunch and Trix. Sales growth for these products indicated that this was a narrower area of opportunity within the overall presweet area. Kellogg developed Froot Loops for the "fruit flavored presweet" area (Tr. 12,869–75; CX–K 526, 909).

118. Kellogg compared the retail prices of certain presweets: Kellogg's Sugar Pops and General Foods' Honeycombs; Kellogg's Sugar Smacks and General Foods' Sugar Crisp; Kellogg's Froot Loops and General Mills' Trix; Kellogg's Cocoa Krispies and General Mills' Cocoa Puffs; General Mills' Corn Bursts and Kellogg's Sugar Frosted Flakes (CX–K 33, 130D). These pricing comparisons indicate Kellogg's belief that the brands compared were more directly competitive with one another than with other brands.

119. General Foods considered introducing an unflavored Pebbles in addition to its two flavored Pebbles products (CX–GF 1372L). It did not do so, however, since it was a presweetened unflavored rice

product like its Sugar Sparkled Rice Krinkles, and might drive Krinkles out of the market. While there were differences, the products were too similar (Tr. 17,456–58).

120. When Kellogg introduced Apple Jacks, it packaged and priced that product competitively with General Mills' Wackies and Lucky Charms, Post's Honeycombs and certain other new items. Kellogg was concerned that Apple Jacks might take sales from its own existing presweets (CX–K 7342B). General Mills considered Apple Jacks to be one of five major competitors of Lucky Charms (CX–GM 604Z–11, 2176E; Tr. 2824–26). **[54]**

11. *Presweetened, Shaped Oat Cereals*

121. Within the overall presweetened segment, presweetened, shaped oat cereals compete more directly with each other than with other presweets. Kellogg tested its All Stars against General Mills' Frosty O's and General Foods' Alpha-Bits to judge consumers' preferences (CX–K 528). All three were presweetened, shaped oat cereals (CX–GM 2). All Stars' introduction was analyzed by Kellogg in terms of its effect on General Mills' Frosty O's and Twinkles (CX–K 604). General Mills thought that the introduction of Kellogg's All Stars adversely affected the sales of General Mills' Twinkles (Tr. 16,621; CX–GM 2). General Foods endeavored to minimize Crispy Critters' cannibalization of Alpha-Bits (Tr. 14,198–99). OK's and Stars "overlapped some," but were not considered by General Foods' Director of Corporate Marketing Services to be identical to General Foods' shaped cereals, such as Alpha-Bits (Tr. 14,220–27).

12. *Chocolate Flavored Cereals*

122. Within the overall presweet segment, the chocolate flavored cereals compete more directly with each other than with other presweets. While the flavored cereals, such as Froot Loops, Cocoa Puffs, Trix, Orange Sugar Crisp, Kream Krunch, Kombos and Krinkles, are the logical direct competitors to Kellogg's Cocoa Krispies, even among these flavored cereals, the chocolate or cocoa flavored cereals, such as Cocoa Puffs, are more direct competitors (Tr. 7563, 7567). Thus, Kellogg compared its Cocoa Krispies to other chocolate flavored cereals (Tr. 12,825). It compared the advertising of General Mills' Cocoa Puffs to that of Kellogg's Cocoa Krispies (CX–K 7175N) and the retail pricing of Cocoa Pebbles to that of its Cocoa Krispies (CX–K 574C). Cocoa Pebbles was a more direct competitor to Cocoa Krispies than were some other products (Tr. 12,296; CX–GF 2021D).

123. Kellogg expected to lose retail support for Cocoa Krispies when it introduced Cocoa Hoots. It noted a declining share trend for cocoa flavored cereals as a category. "It's possible that the market is over-saturated with cocoa-flavored products." Other cocoa flavored cereals were Cocoa Puffs, Count Chocula and Cocoa Pebbles (CX–K 7205D). Kellogg sought to acquire more of the chocolate flavored segment with Chocolate Kombos (CX–GM 2171B).

124. General Mills believed that Cocoa Krispies and Cocoa Puffs were more closely competitive with one another than with other cereals (Tr. 15,747; CX–GM 2171A). It concluded that its Cocoa Puffs should be "priced right with the Kellogg product," Cocoa Krispies (CX–GM 278A). **[55]**

13. *Fruit Flavored Cereals*

125. Within the overall presweet cereal segment, the fruit flavored cereals compete more directly with each other than with other presweets. Kellogg identified the fruit flavored presweets as an area that presented an opportunity for a new brand. This was indicated by the sales growth of General Mills' Trix in this subsegment. Kellogg, therefore, introduced Froot Loops (Tr. 12,875–76). Kellogg's Apple Jacks is a flavored cereal. Therefore, its logical competitors are other flavored cereals; then, to a lesser degree, other presweetened cereals (Tr. 7566).

126. Anticipating that General Mills' Lucky Charms would be a close competitor to Kellogg's Froot Loops, Kellogg's product manager recommended an increase in Froot Loops' advertising to "take the steam away" from the introductory advertising for Lucky Charms (CX–K 596).

127. The Director of Marketing for General Mills' cereals thought that there was a competitive set of fruit flavored cereals competing more directly with General Mills' Trix. Froot Loops was Trix's most directly competitive cereal (Tr. 16,599, 16,742; CX–GM 19B). The competitive environment for Trix was all children's cereals, but the product that was watched most closely by General Mills' marketing people was Froot Loops (Tr. 18,015).

128. General Mills did a market test to determine which of two flavor levels of its Trix was superior when tested in the context of a set of fruit flavored cereals. It tested only against Trix's key competitor, Froot Loops, "because there wasn't anything else really in that category that was a sufficient alternative for the consumers" (Tr. 15,814–15).

129. General Foods concluded that its Pebbles "is more likely to

attract users of Froot Loops than it is to attract users of other brands" (Tr. 14,461–62; CX–GF 2021D).

130. General Foods determined that, within the overall presweet market, fruit and cocoa flavored cereals were growing at a faster rate than unflavored cereals. General Foods, at the time, did not have any products in these two flavored presweet segments. Subsequently, Fruity Pebbles was tested against Froot Loops and Cocoa Pebbles was tested against Cocoa Krispies—"head-on-head" (Tr. 17,443–44).

14. *Rally and Life*

131. Kellogg expected its Rally to compete most directly with Quaker's Life. Kellogg's Rally was aimed at the market in which Life was the leading cereal. Kellogg's estimate of sales for Rally were based on the sales of Ralston's Chex-type products and on Life (CX–K 742A–B, 7235B, 7239). **[56]**

132. Mr. Wells, Kellogg's New Products Marketing Manager, testified that when he prepared a suggested retail price for Rally, the only directly competitive brand he could recall comparing was Quaker's Life (Tr. 11,735–40).

133. Kellogg recognized Life as Rally's closest, though not its only, competitor, and tested Rally for consumer preference against Life. Kellogg knew that, in competing with Life, it would need to match the marketing efforts, both advertising and promotion, of Life (Tr. 11,700; CX–K 530).

15. *Sugar Smacks and Sugar Crisp*

134. Kellogg's Sugar Smacks and General Foods' Sugar Crisp are more directly competitive with one another than they are with other cereals. Kellog believed Sugar Crisp to be Sugar Smacks' most direct competitor (Tr. 12,384; CX–K 7175N). When vitamin fortification of Sugar Crisp and inserts caused a softening of Sugar Smacks' sales, Kellogg responded by fortifying Sugar Smacks to the same level as Sugar Crisp (CX–K 595, 7175N, 7352B–C; Tr. 7559, 7603, 12,384, 13,130–33).

135. Sugar Crisp, termed by Kellogg the logical, direct competitor to its Sugar Smacks, was said to have gained sales from Sugar Smacks and Quaker's Cap'n Crunch, Quisp and Quake, as a direct result of the insert in the Sugar Crisp package. Kellogg's own insert in Sugar Smacks was expected to result in reducing Sugar Crisp's sales to "normal levels." Puffa Puffa Rice was also included in

Kellogg's analysis of "sweetened puffed products" (CX–K 650A–B; Tr. 7559).

136. General Foods priced Sugar Crisp in terms of the pricing on the "identical Kellogg brand," Sugar Smacks (CX–GF 418D, 1381S, 1410L).

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137. Kellogg had what may be termed a market or brand segmentation study prepared for it by its advertising agency, Leo Burnett (Tr. 12,892–99; CX–K 9012). That study, prepared sometime between 1951 and 1972, came up with six groups or segments as follows:

Group I cereals are Kellogg's Corn Flakes, Rice Krispies, Post Toasties, Special K, Wheaties, and Cheerios. Because these cereals "are perceived as having similarities," they "are seen as somewhat interchangeable." Bringing these cereals together is their "plain" or "bland" taste. [57]

They are also seen as the "old, established, traditional brands." The "plain" tasting cereals contrast with flavored cereals. They are good fruit carriers and sugar is added individually (CX–K 9012G–K).

The Group II cereals are the "kid flavored cereals" including Pebbles, Quisp, Cap'n Crunch, Lucky Charms, Kaboom, King Vitaman, Froot Loops, Cocoa Puffs, Trix, and Apple Jacks. They are presweetened. They are not bland, but carry a "multitude of flavors." Pebbles, Froot Loops and Trix are seen by consumers in very similar ways. These cereals are defined in terms of their sweet, multi-fruit flavors by those who like them (CX–K 9012M–N).

Group III are presweetened, but not flavored. They include Sugar Pops, Sugar Crisp, and Sugar Smacks. These cereals have rather definite grain tastes, not an added flavor. They are less bland than the Group I cereals. Another similarity is that they are puffed (CX–K 9012Q–R).

Group IV are the shredded wheat cereals, spoon size and regular shredded wheat, Mini-Wheats, and Wheat Chex. This group is "clearly defined by the texture of its primary ingredient," wheat. There is a distinctive wheat taste, and they are not good fruit carriers (CX–K 9012T, V).

Group V consists of the Kellogg and Post raisin brans alone, with "nothing else quite like them." "[R]aisins are the most salient feature of these cereals" (CX–K 9012V).

Group VI are the adult nutritional cereals which include Total, the Post and Kellogg 40% bran flakes, Product 19, Fortified Oat Flakes, and to a lesser extent, Special K, Grape Nuts, and Wheaties. The first four are soggy and flaked and possess a strong taste. They are "good for you" (CX–K 9012W–X).[13] [58]

138. The situation just described is termed "localization" by

[13] This is a partial summary of the findings of the study. *See* CPF 9–94. Except for quoted words and phrases, this is not a verbatim reproduction of any part of the study.

complaint counsel and is central to their contention that respondents created a barrier to entering the RTE cereal industry by their proliferation of products. However, as indicated above, localization is a matter of degree and cereals do compete to varying extents with other than so-called directly competing products and products in their particular category or segment (Tr. 22,794).

139. This is true, to some extent, because individual cereal products possess a number of attributes and many other cereals also contain a number of these same attributes; and, there is a considerable overlapping of attributes even among cereals not deemed directly competitive.

140. Consumers aged 35 and older consume certain products ("adult products"), which are not eaten in any significant amounts by children 13 years old and younger. Adult products include Total, Special K, Product 19, All Bran, 100% Bran and 40% Bran Flakes. Children consume certain products ("child products") which are not eaten in significant amounts by adults. Child products are essentially the presweets. Certain products ("all-family products") are eaten in substantial amounts by consumers of all ages (Tr. 35,367–70). All-family products include Cheerios, Rice Krispies and Corn Flakes. Child and all-family products compete with each other (GMX 546A, 549A). Adult and all-family products compete with each other. (Tr. 8824–25, 35,367–68, 35,372–87; GMX 194, 195, 547A–B, 548A–B).

141. Although only 16.2% of Cheerios' volume is consumed by individuals 35 years of age and over (GMX 547A), this is a substantial figure. It is such a large volume that Cheerios cannot ignore that group of consumers and advertises and promotes to them (Tr. 35,378–79, 35,386–87).

142. Cheerios does not achieve its volume increases strictly at the expense of products such as Cap'n Crunch, Sugar Frosted Flakes or Rice Krispies. It very likely draws from many different consumers who eat many different products (Tr. 35,370–71).[14] For example, a brand switching analysis shows that of the two-member families who purchased Cheerios in 1969–70 each of 21 other brands accounted for over 1% of their consumption (GMX 518A). In 1975–76, for a similar sample of families, 25 other brands each represented more than 1% of their consumption (GMX 518B).

143. Lucky Charms, a child cereal, need not be concerned with adult cereals; but children who consume Lucky Charms also consume many other child products (GMX 546A, 549A). **[59]**

144. Total, an adult cereal, competes with many other adult and

[14] This is true of other all-family products (Tr. 12,791, 15,137, 17,392–95, 35,367, 35,384, 35,392).

all-family products, including Special K, Grape Nuts, Post 40% Bran Flakes and Product 19 (GMX 525A; Tr. 33,730–31, 33,743–44, 33,751, 33,753, 33,899–900, 35,397–400).

145. Kellogg's Corn Flakes appeals to all age groups and, in a sense, competes with every other cereal on the shelf (Tr. 7566). The brand switching analyses referred to above (Finding 142) show that two member families consuming Kellogg's Corn Flakes had more than 1% of their consumption accounted for by each of 20 other brands in 1969–1970 (GMX 520A), and by each of 23 other brands in 1975–1976 (GMX 520B).

146. Apple Jacks competes with all flavored cereals and most other presweetened products (Tr. 7566).

147. General Foods' market planners believed that all cereals were competitive with Sugar Crisp, although Sugar Crisp was primarily competitive with other presweetened cereals (CX–GF 4K, 1410A).

148. A General Foods market research review of Grape Nuts in 1956 stated: "Because of its distinct flavor, unique form and texture [Grape Nuts] does not fall into any specific category, and competes with all RTE cereals for its share" (CX–GF 40).

149. The 1963 Menu Census concludes that there "is a strong usage relationship between Post Raisin Bran and Post presweetened cereals" (GFX 1210Z–5).

150. A FY 70 review by General Foods' Marketing Division states that "Alpha Bits is the only letter-shaped cereal and is primarily competitive to colored, flavored and shaped presweetened brands" (CX–GF 1382). The FY 72 Management Summary for Crispy Critters describes that product as a "unique, fun to eat, animal shaped, presweetened cereal primarily competitive with other presweetened cereals that possess shapes, additives or flavors" (CX–GF 1417A). Pink Panther Flakes was considered to be in competition "to all children's presweetened cereals" (CX–GF 1439). Cocoa Pebbles "frequently interacted" with Cap'n Crunch and Frosted Rice, in addition to chocolate flavored cereals (GFX 1317).

C. *The Relevant Geographic Market—The United States As A Whole*

1. *Use by Major Producers of National Price Lists*

151. The price lists issued by the RTE cereal companies show uniform national prices for each brand. Kellogg lists a single price for each brand for all states within the United States, except for Hawaii (CX–K 828, 846, 856, 861, 866, 869). General Mills' and **[60]**

General Foods' RTE cereal list prices are each uniform for the entire United States, except for Alaska and Hawaii (CX–GM 440, 452, 469, 502; CX–GF 297, 311, 314). Quaker and Ralston each issue price lists which show a single price for each RTE cereal brand throughout the country (CX–Q 430, 432, 434, 436; CX–R 579, 580 thru 591).

152. Except when a product is being test marketed, the major RTE cereal companies generally sell their products nationally (CX–K 1067; CX–GM 2111, CX–GF 556; CX–Q 2983). During a test market, companies introduce the new product in selected regions and, if the product meets its expected sales volume, the sales regions are expanded in a planned sequence, often termed a "roll-out." When the roll-out has been completed, the product is distributed on a national level (Tr. 12,537–38, 16,009–11, 16,035–36, 29,773, 29,991).

2. *Purchase By Major Producers Of National Market Share Data*

153. Each respondent and Quaker subscribed to services provided by the A.C. Nielson Company (Tr. 7728–29, 7732, 8604–05, 11,550, 12,802, 14,349, 14,351, 15,594–96). A typical report purchased from Nielson by these companies contains, among other data, information on the total national sales of RTE cereals, average nationwide consumer prices for individual products, national market shares and advertising of individual brands, national distribution and out-of-stock conditions reflecting retailers' temporary product shortages, and estimates of national consumer sales on both a dollar and a pound basis (KX 14). Respondents used Nielson as a medium for exchange of national advertising expenditures on a total RTE cereal basis and on a brand-by-brand basis nationwide (Tr. 11,842–43, 14,233, 14,354, 14,356–58, 15,596–98, 15,600–01; CX–ACN 2; CX–GM 176).

154. Similar nationwide information was purchased by respondents from Market Research Corporation of America (MRCA), Selling Area Marketing Information (SAMI), and National Purchase Diary (Tr. 7464, 11,764, 12,784, 14,365, 16,031, 16,062–66, 29,591, 34,349; CX–GF 1380; CX–K 560; CX–GM 604Z–5).

3. *Preparation By Respondents Of Nationwide Marketing Plans For Their RTE Cereals*

155. The internal marketing plans prepared by the RTE cereal companies discuss the total RTE cereal market on a national basis, the nationwide performance of various segments of the RTE cereal market, and also the nationwide performance of individual cereals

considered in the context of a national market (CX–K 7175 thru 7179; CX–GM 2170; CX–GF 1300; CX–Q 155). **[61]**

156. In 1965, Kellogg's marketing plan for its presweetened cereals considered the impact of a limited national roll-out of Cap'n Crunch and the national introduction of General Mills' Lucky Charms and Crispy Critters (CX–K 7357F). In planning media strategy for Count Chocula and Frankenberry, General Mills decided that "a combination of child network and spot television will be used [in 1972/73] support of in-pack premium promotions to achieve national reach and impact" (CX–GM 2198C–D). A marketing analysis of the raisin bran segment attributed the growth in that segment to a nationwide increase in the absolute number of households consuming raisin bran cereals and to a nationwide increase in the consumption of raisin bran cereals per household (CX–GF 2000D). According to Quaker's 1968–1969 marketing plan for Life, among the factors favorable to the growth of the nutritional segment was an increase in the nationwide percentage of better-educated people and wealthier families (CX–Q 155B).

4. *Use By Major Producers Of Nationwide Network TV And Other Media To Sell Their RTE Cereals*

157. Because of the national scope of the RTE cereal market, Kellogg uses network television to advertise its products. Network television provides nationwide television coverage for Kellogg's advertising efforts (Tr. 11,379–80). Part of Kellogg's 1970–1971 media strategy for Corn Flakes was to use "nighttime TV as the primary medium to provide continuing national support against the primary target audience of younger families with children as well as older adults" (CX–K 7181L). Similarly, television is the primary medium for Kellogg's Raisin Bran because of its national coverage (CX–K 7177G, 7184M, 7187Q).

158. General Foods planned to use "kid network" 30-second advertisements for Honeycomb in 1971 to take advantage of the medium's ability to generate efficient national reach of children under 12 years of age. Additionally, "kid network allows the brand to effectively tie-in with planned show-oriented promotions" (CX–GF 1383, 1374N). General Foods admitted making substantial expenditures for network television advertising for its RTE cereals (General Foods Admission of Fact 37).

159. In 1970–1971, General Mills planned to use night network television advertising for Wheaties "to provide a national base of continuity against the target family audience and deliver optimum

reach" (CX–GM 2172C; *and see,* CX–GM 2167, 2171). General Mills has admitted making substantial expenditures for network television advertising for its RTE cereals for the years 1965 through 1970 (General Mills Admissions of Fact 56, 58, 59, 60, 63, 64, 65, 68, 82, 83, 90). **[62]**

160. Quaker also used network television to advertise its RTE cereal products (Quaker Admission of Fact 108; CX–Q 151G, 153I, 154J).

161. The above findings compel the conclusion that the relevant geographic market is the United States as a whole.

III. STRUCTURE OF THE RTE CEREAL INDUSTRY

162. The RTE cereal market is large and has experienced rapid and substantial growth. Following are the dollar sales of RTE cereals through grocery stores for the years 1952 through 1971, as reported by Nielsen:

Year	Total Dollar Sales ($ millions)
1952	237
1953	254
1954	265
1955	280
1956	312
1957	336.4
1958	379.8
1959	401.1
1960	421.1
1961	449.5
1962	480.3
1963	527.8
1964	577.5
1965	624.6
1966	655.7
1967	656.0
1968	679.3
1969	710.0
1970	741.2
1971	782

(CX 101F).[15] **[63]**

[15] General Mills (GMPF 5–15 thru 18) challenges the reliability of CX 101 and 106 (market share data) asserting that Nielsen data, upon which they are based, are not accurate; that General Mills' Director of Consumer Research testified (Tr. 16,161–63) that Nielsen's figures for several products were not in accord with General Mills' own actual sales figures for those products.

However, all respondents subscribed to Nielsen services, including those that furnished sales data (Tr. 15,595), and all used and relied upon the sales data so furnished (Tr. 11,489–90, 12,782–83, 13,349–50, 15,725, 15,842, 16,063, 16,163). While General Mills' Director of Consumer Research testified to some differences, he explained that

(Continued)

163. Total industry sales showing growth in pounds for the period 1940–1975 at five year intervals is as follows:

INDEX OF GROWTH IN TOTAL RTE CEREAL INDUSTRY POUND SALES
1940 = 100

Year Ending 12/1	Sales MM lbs.	Total Index
1940	458	100.0
1945	594	129.7
1950	610	133.2
1955	783	171.0
1960	941	205.5
1965	1178	257.2
1970	1183	258.3
1975	1688	368.6

(CX 101E). **[64]**

164. The preceding tables show that, until the mid-1960s, there was rapid growth in pound sales of RTE cereals (*And see*, Tr. 26,157). From 1966 through 1970, there was almost no growth. The industry was relatively stable in terms of pounds and had a modest growth in terms of dollars. Rapid growth resumed after 1970. Between 1970–1971 and 1975–1976, the total RTE cereal market grew 55%. There was very rapid growth, particularly in 1973 and 1974 when the market was growing at an annual rate of 10% or 11% (Tr. 14,021, 17,684–85, 26,158).

165. RTE cereal pound sales grew considerably faster than other sectors of the economy. For the period 1952 through 1966, RTE cereal pound sales grew by 72.8%. Using the Economic Report of the President, which uses constant dollar GNP, the "all goods and services" group grew by 63.9% in real terms over the same period. A comparison of these differences shows that growth of output was considerably faster for RTE cereal than it was for the economy as a whole. For the same period, growth in RTE cereal dollar sales was 176.8%. GNP data from the President's Economic Report, which is based on current dollars unadjusted for inflation, show that the growth for "all goods and services" was 116.9%. RTE cereal dollar sales grew at an average of about 8.7% a year for the period 1955 to 1959, while the "food and kindred products" growth rate was 3.74%,

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General Mills' figures covered point of sales from General Mills whereas Nielsen's figures reflected sales at the store level, so that pipeline delays accounted for some of the differences (Tr. 16,167). Further, he was not prepared to testify to the accuracy of Nielsen's overall figures (Tr. 16,163); and General Mills failed to introduce its own sales figures which were available to it.

Kellogg's Marketing Director testified (Tr. 12,795) that, in his opinion, Nielsen's sales figures were generally accurate and that they were relied on by Kellogg. Under all these circumstances, the Nielsen sales data are deemed reliable. *See Borden, Inc.*, 92 F.T.C. 669, 805 n. 40 (1979); and *General Foods Corp.*, 69 F.T.C. 380, 446–47 (1966), for precedents where the Commission has relied upon Nielsen data.

the "nondurables" growth rate was 5.48% and the "all-manufacturing" growth rate was 6.52%.

166. The RTE cereal industry, therefore, has been experiencing rapid growth. Its growth has been substantially faster than the growth in the value of "all goods and services" and substantially faster than the growth in real output of the economy as a whole. (Tr. 21,834, 25,158–59; CX 101E, F).[16]

167. For each year since at least 1940, there have been only six manufacturers of RTE cereal that produced in substantial quantity. The three largest have been Kellogg, General Mills and General Foods, followed by Quaker, Nabisco and Ralston, although not always in that order. From 1943 to 1970, these six firms accounted for at least 89% of industry sales, either on a pound or dollar basis. That 89% figure was in 1943. In 1970, these firms enjoyed over 97% of the market (CX 106A–G).[17] The following chart shows four-firm concentration ratios for the industry from 1962 through 1970: **[65]**

[16] General Mills, for example, favorably compared an RTE cereal annual growth of 7% with the 4% growth of the canned soup industry. The latter was considered by it to be a strong annual growth (CX–GM 111A). General Mills deemed the long-term growth of cereal sales to be phenomenal (CX–GM 262A). And Kellogg regarded cereals to be "one of the few rapidly expanding industries" (CX–K 552B).

[17] There has been no new major entry to challenge the positions of these six companies (Tr. 7435–36, 11,749, 12,911–12, 12,995).

RTE CEREAL INDUSTRY FOUR-FIRM CONCENTRATION RATIOS

	POUND BASIS				DOLLAR BASIS	
Year	Nielsen Data from General Foods and Kellogg [1]	Nielsen Data [2]	Adjusted Co. Submitted Data [3]	Adjusted Co. Submitted Data, Brand Products Only [4]	Adjusted Co. Submitted Data [5]	Adjusted Co. Submitted Data, Branded Prod's Only [6]
1962	89	–	90	90	90	90
1963	90	–	–	–	–	–
1964	90	–	–	–	–	–
1965	89	88	–	–	–	–
1966	88	88	89	89	90	90
1967	88	88	89	89	91	90
1968	88	–	90	89	91	91
1969	90	–	90	90	91	91
1970	89	–	90	90	92	91

[1] Source: CX 106A.
[2] Source: CX 106B.
[3] Source: CX 106F.
[4] Source: CX 106G.
[5] Source: CX 106D.
[6] Source: CX 106E.

[66]168. Since at least 1937, the four-firm concentration ratio based on pound sales has never been below 81%. And Kellogg, General Mills and General Foods together have accounted for over 80% of the pound sales from 1951 through 1971 (CX 106A, B, F, G). In 1950, Kellogg's share of the market was between 35% and 37%, on either a pound or dollar sales basis; in 1970, it's share approximated 44%. General Mills' share of the total RTE cereal market for both 1950 and 1970 was approximately 20%, on either a pound or dollar sales basis. In 1950, General Foods' share of the total RTE cereal market was approximately 22% based on dollar and pound sales. By 1970, its market share had declined to approximately 17.7% based on pound sales, and 14.8% based on dollar sales (CX 106A–G).

169. Quaker's share of the RTE cereal market, based on pound sales, was between 4.1% and 5.0% in 1950, dropped to approximately 2.4% in 1960, and rose to about 7.0% in 1970. Quaker's market share, on a dollar sales basis, went from 6.6% in 1950 to approximately 9.0% in 1970. Nabisco's share of the market, based on pound sales, was 9.3% in 1950 and approximately 4.8% in 1970; on a dollar basis its market shares were 6.6% and 3.7%, respectively. Ralston's share of the RTE cereal market, based on branded pound sales, grew from approximately 3.0% in 1950–1951 to approximately 5.0% in 1960. It declined to approximately 3.8% in 1970. If Ralston's private label sales were included, its market share would be somewhat greater (CX 106A–G).

170. Another measure of industry concentration, the Herfindahl Index, is calculated by summing the squares of each firm's market share. The Herfindahl Index differs from the more commonly used concentration ratio in that it shows a higher figure for industries where individual firm market shares are disproportionately high. For example, an industry in which the four largest firms had 50%, 10%, 10%, and 10% of the market, respectively, would have a higher Herfindahl figure than an industry where the four largest firms each had 20% of the market. Despite this difference in result, there is a correlation between four-firm concentration ratios and the Herfindahl Index. Highly concentrated industries have high Herfindahls. Industries that are not highly concentrated have low Herfindahls (Tr. 21,709–11, 26,215–21).

171. The Herfindahl Index for the RTE cereal industry has increased from .223 in 1945 to .276 in 1970 (CX 106A–G).[18] The following chart shows the Herfindahl Indices for the RTE cereal industry using several available alternate sources: **[67]**

RTE CEREAL INDUSTRY HERFINDAHL INDICES

	POUND BASIS				DOLLAR BASIS	
Year	Nielsen Data from General Foods and Kellogg [1]	Nielsen Data [2]	Adjusted Co. Submitted Data [3]	Adjusted Co. Submitted Data, Brand Products Only [4]	Adjusted Co. Submitted Data [5]	Adjusted Co. Submitted Data, Branded Prod's Only [6]
1962	0.270	–	0.286	0.284	0.305	0.304
1963	0.276	–	–	–	–	–
1964	0.278	–	–	–	–	–
1965	0.273	0.262	–	–	–	–
1966	0.262	0.266	0.281	0.280	0.292	0.291
1967	0.269	0.268	0.277	0.275	0.286	0.285
1968	0.268	–	0.283	0.282	0.294	0.294
1969	0.274	–	0.287	0.286	0.293	0.292
1970	80.276	–	0.289	0.288	0.294	0.293

[1] Source: CX 106A.
[2] Source: CX 106B.
[3] Source: CX 106F.
[4] Source: CX 106G.
[5] Source: CX 106D.
[6] Source: CX 106E.

[68]172. By various alternative methods of comparison, including rankings of industries by concentration ratios, averages of concentration ratios, and averages of Herfindahl Indices, the RTE cereal

[18] The Herfindahl Indices for the RTE cereal industry are somewhat understated inasmuch as they were calculated using market shares of only the six largest producers, where data were available. Inclusion of the squares of the market shares of the smaller firms would have raised the industry indices.

industry has been one of the most highly concentrated industries in the United States (Tr. 26,166–67).

173. Census Bureau classification Standard Industrial Code 2043, entitled Cereal Breakfast Foods (SIC 2043), includes RTE cereals, hot cereals and baby cereals. As hot cereals and baby cereals comprise a relatively small fraction of the classification, SIC 2043 is a good approximation of the RTE cereal market (Tr. 26,194–99, 26,207, 27,672–73).[19]

174. In 1958, SIC 2043 had a four-firm concentration ratio of 83%. Only 29 of the 443 industries engaged in manufacturing (the All Manufacturing Group) that year had concentration ratios greater than 80%. Two-thirds of the industries in this group had concentration ratios of less than 50%. Only three of the 42 industries engaged in the manufacture of food and kindred products (the Food Group) had concentration ratios greater than 80%, while two-thirds of those industries had concentration ratios of less than 50% (Tr. 26,181–82; CX 108D).

175. In 1963, SIC 2043 had a four-firm concentration ratio of 86%, ranking it among the 27 industries in the All Manufacturing Group with concentration ratios above 80%. More than two-thirds of the 417 industries in this group had concentration ratios of less than 50%. Only one industry in the Food Group, in addition to cereals, had a concentration ratio greater than 80%. Two-thirds of the 44 industries in the Food Group had concentration ratios of less than 50% (Tr. 26,179–80; CX 108C).

176. In 1967, only 22 of the 354 industries in the All Manufacturing Group had four-firm concentration ratios higher than 80%, one of which was SIC 2043 with a concentration ratio of 88%. It was one of only two industries in the Food Group with four-firm concentration ratios over 80%. Two-thirds of the industries in the All Manufacturing and Food Groups had concentration ratios less than 50% (Tr. 26,178; CX 108B).

177. The four-firm concentration ratio for SIC 2043 in 1972 was 90%. SIC 2043 was one of the 11 most concentrated in the All Manufacturing Group, comprised of 381 industries, and it was the most concentrated of the 43 industries in the Food Group in 1972. Again, two-thirds of the industries in the All Manufacturing and Food Groups had concentration ratios of less than 50% (Tr. 26,167–72; CX 108A). **[69]**

178. The simple arithmetic average of four-firm concentration ratios for 1972 was 39% for the All Manufacturing Group and 44%

[19] Actually, the inclusion of hot cereals and baby cereals would tend to understate the concentration of the RTE cereal industry.

for the Food Group. The four-firm concentration ratio for SIC 2043 in 1972 was more than twice those averages, 90%. In that same year, the eight-firm simple arithmetic concentration average was 52% for the All Manufacturing Group and 58% for the Food Group. The eight-firm figure for SIC 2043 in that year was 98% (Tr. 26,185–86).

179. CX 108J is a set of tables prepared by the Bureau of the Census which shows average concentration ratios, weighted by industry employment, for the All Manufacturing Group and for the Food Group. The weighted average four-firm concentration ratio for the All Manufacturing Group in the years 1947, 1954, and 1958 ranged from 33.2% to 34.9%, depending on the base year used to determine the employment weights. The weighted average four-firm concentration ratio for the Food Group for the same years ranged from 30.9% to 33.2%, again depending upon the base year used in determining the weights. The four-firm concentration ratio for the cereal industry (SIC 2043) was 79% in 1947, 88% in 1954 and 83% in 1958 (Tr. 26,186–90; CX 108J).

180. The average concentration ratio, weighted by product value for 184 manufacturing industries which appeared in all four of the Census years 1947, 1954, 1958, and 1963, ranged from 35.3% in 1947 to 38.9% in 1963. The ratios for SIC 2043 again are significantly higher than the averages, ranging from 79% in 1947 to 86% in 1963 (Tr. 26,190–92).

181. The RTE cereal industry is highly concentrated in relation to other industries when comparing Herfindahl Indices of concentration. For 108 four-digit industries in 1947, the average four-firm Herfindahl Index was .0968.[20] During that same year, the four-firm Herfindahl Index for SIC 2043 was .1609. Of the 108 industries which made up the average Herfindahl Index, only 18 industries had higher Herfindahls than did SIC 2043. In 1954, the average Herfindahl Index for the 93 industries covered was .0921, while the Herfindahl for SIC 2043 was .4026. Of the 93 industries which made up the average Herfindahl Index for 1954, only four had higher Herfindahls than did SIC 2043 (Tr. 21,821–24, 26,218–22; CX 106A–G, 108S, T). **[70]**

182. In addition to concentration being consistently high for many years in the RTE cereal industry, the positions and market shares of the leading firms have remained relatively stable (CX 106A–G; Tr. 26,230–31, 26,498–504). Until about 1966 or 1967, the four largest producers in the industry were the three respondents

[20] The average Herfindahl Index was calculated from industry Herfindahls compiled by Ralph L. Nelson using Bureau of the Census data (Nelson, *Concentration in the Manufacturing Industries of the United States* 1963). Nelson's book contains Herfindahl Indices for a number of large industries for the years 1947 and 1954 (Tr. 26,218–19).

and Nabisco, at which point in time Quaker replaced Nabisco as the fourth largest (CX 101A–D, 106A–G). Of 44 five-digit product classifications for which necessary information was available covering the years 1954, 1958, 1963, 1967, and 1972, the RTE cereal industry had the third lowest fluctuation in four-firm levels of concentration. Of 47 such product classifications for which the necessary information was available, the RTE cereal industry had the sixth lowest fluctuation in eight-firm concentration levels (CX 108L; Tr. 26,231–33).

183. Various renowned economists have specified certain industry concentration levels as "critical" in the sense that, at or above such levels, sellers become conscious of their interdependence, *i.e.*, that the action of each seller affects all of the others; and that this recognition of interdependence may lead to a pattern of conduct that causes monopoly power to be exercised. Bain, Meehan, Duchesneau and others have estimated that the critical level is reached when an industry has an eight-firm concentration ratio of 70%. Most studies of economists who espouse the "critical level" theory estimate the four-firm critical level of concentration to be between 50% and 60%, although Stigler found that a 70% four-firm concentration was required to be critical (Tr. 21,711–16). The concentration levels of the RTE cereal industry, as found above, far exceed all of the various estimated critical levels.

The above finding should not be construed as one to the effect that respondents are conscious of their interdependence with the result that they have or are exercising monopoly power by means of tacit collusion or otherwise. It is merely a finding as to the existence of the economic theory of critical levels, and that concentration in the RTE cereal industry exceeds the critical levels that have been estimated. Not all economists agree with the critical level concept (Tr. 21,713). [71]

IV. COMPETITION

A. *Industry Characteristics*

Complaint counsel assert (CP 136) that respondents exercised monopoly power by avoiding price and nonprice competition on RTE cereal products. Complaint counsel theorize that in a tightly knit oligopoly, such as the RTE cereal industry, each firm recognizes that its actions and the actions of each of its competitors will have an impact upon the other competitors. It takes into account the other firms' anticipated reactions in every potential competitive decision that it makes. Such firms, in economic parlance, are termed

"interdependent". In such a situation, the firms recognize that it is to their mutual advantage to avoid competitive activities which will only bring about responsive competitive activities by their large competitors. The firms, therefore, avoid such competitive acts in accordance with understood "rules of the game." In order to so successfully avoid competition, all major firms must participate.

These interdependent firms consider unrestrained competition in any dimension to be undesirable because competition of any type would have the potential of breaking down the tacit agreement to limit competition and maximize group profits. Not only must the firms trust each other, but they must all understand the rules of the game so that no action of any of the participants may be misinterpreted to be other than complying with the rules of the game.

184. In support of their structural approach, complaint counsel rely (CPF 8–74) upon an economic theory set forth by Dr. Jesse W. Markham in The American Economic Review, Vol. XLI (1951), pp. 891–905, in an article entitled "The Nature and Significance of Price Leadership." A reprint of that article was received in evidence as KX 104. KX 104 is paginated 176–189. Dr. Markham is a professor in the Graduate School of Business Administration at Harvard and was Director of the Bureau of Economics of the Federal Trade Commission from 1953 until the end of 1955. Complaint counsel have stipulated to Dr. Markham's credentials as a recognized expert in the field of industrial organization economics (Tr. 38,253–55).

185. In his article, Dr. Markham advanced the proposition that "in industries which possess certain specific features, . . . one would expect, *a priori,* a type of price leadership . . . inimical to the public interest." He termed this Price Leadership In Lieu Of An Overt Agreement and reasoned that such price leadership could achieve the same parallel action among sellers as if there had been overt collusion to that end (KX 104 at 185–86). Dr. Frederick Scherer, the economist introduced by complaint counsel who sought to apply Dr. Markham's model to the RTE cereal industry, testified that the Markham article "is widely regarded by economists as the leading article on the subject of price leadership in industry. It has been extensively reprinted" (Tr. 27,801). **[72]**

186. Dr. Markham listed five specific conditions prerequisite to application of his Price Leadership In Lieu Of An Overt Agreement thesis. The first condition is:

> Firms must be few in number and each firm must be sufficiently large to be compelled to reckon with the indirect as well as the direct effects of its own price policy (KX 104 at 186).

187. As further elucidated by Dr. Markham, when this condition is met, industry members would be cognizant of the fact that there is a common course of action that would benefit all of them (Tr. 38,426). The high concentration ratios for the relatively few leading firms in the industry, headed by Kellogg with some 40% of the market, satisfy this condition.

188. The second condition:

> Entry to the industry must be severely restricted if the price set by the price leader is to remain close to a rationalized oligopolistic price for any significant length of time. If the long-run cost curve for the new entrant is substantially the same as those which confront entrenched firms, price rationalization can be only temporary since the rationalized price will attract new entrants which, in turn, will bid the price down. If, however, the time lag between investment decisions and actual investment in the industry is significant, price rationalization for the duration of the lag may suggest itself as a profitable possibility (KX 104 at 186).

189. In discussing restriction of entry, we are not limited to "barriers to entry" as that phrase is used by economists. In this industry, we have had no entry except with respect to granola or natural RTE cereals, which is an exceptional situation (*infra*, Findings 661, 662). This in itself reflects severe restriction to entry. The extent to which this may be attributable to high costs of entry by an outsider, including costly and time consuming or even unsolvable problems in developing an acceptable competitive product [73](situations not deemed by some economists to constitute barriers to entry), is immaterial.[21]

190. Expansion through the introduction of new products by existing firms would not be considered as entry here since the expansion would be by firms theoretically engaged in price coordination through price leadership. This disposes of respondents' argument that Quaker's expansion, as well as the introduction of new products by the several respondents, constituted entry.

191. It is concluded, therefore, that the second condition of Dr. Markham's economic theory is satisfied.

192. The third condition:

> The "commodity" produced by the several firms need not be perfectly homogeneous but each producer must view the output of all other firms as extremely close substitutes for his own. If this condition is not fulfilled, each producer is likely to view

[21] In the face of long and costly efforts to effect entry, together with the very real possibility that the new product may not be accepted by consumers, a potential entrant may decide against entry. Even though it is not deterred by a "barrier to entry," the deterrence, nevertheless, is real.

Further, in the face of such high costs, long delays and problematical success, a potential entrant might well decide against entry since it would realize that once it effected substantial entry, it could not count on a continuation by existing firms of prices that afforded supracompetitive profits. An oligopolistic price, therefore, will not automatically draw new entry since this may well not be the price at which the new entrant will anticipate competing.

his product as distinctive in character and the "market" will not be characterized by a single price policy but by several. Examples of such individual pricing policies may be found in the automobile and brand-name men's clothing markets. Where the output of each firm is differentiated to the extent that it is only a moderately good substitute for the output of other firms, price leadership, of course, is meaningless (KX 104 at 186).

193. This condition is not present in the RTE cereal industry. To the contrary, as I have already found (Findings 59–150), the RTE [74] cereal market is segmented into numerous subcategories, with cereals competing primarily against other cereals in their own categories. And, in many instances, two or three cereals within a segment compete primarily with each other. Indeed, this segmentation or localization of cereals is an essential element of complaint counsel's contention that respondents have created a barrier to entry of new competition into the industry by reason of their proliferation of brands.

194. Some of the segments and competing cereals previously identified are: corn flakes; wheat flakes; variety packages; Rice Krispies, OK's, Alphabets and Cheerios; nutritional cereals; raisin brans; whole bran; 40% brans; shredded wheat; presweets; presweetened shaped oat cereals; chocolate flavored cereals; fruit flavored cereals; Rally and Life; and Sugar Smacks and Sugar Crisp.

195. Among the various RTE cereals distributed by the respondents and Quaker during the period 1950–1972 are the following:

Kellogg: Apple Jacks, Bran Buds, Chocolate Kombos, Cinnamon Frosted Mini-Wheats, Cocoa Krispies, Concentrate, Corn Flakes with Bananas, Froot Loops, Kellogg's All-Bran, Kellogg's 40% Bran Flakes, Kellogg's Corn Flakes, Kellogg's Jumbo Assortment, Kellogg's Raisin Bran, Kellogg's Request Pack, Kellogg's Snack-Pack, Kellogg's Variety, Krumbles, OK's, Orange Cream Krunch, Orange Kombos, Pep, Product 19, Puffa Puffa Rice, Rally, Rice Krispies, Special K, Stars, Strawberry Cream Krunch, Strawberry Kombos, Sugar Frosted Flakes, Sugar Frosted Mini-Wheats, Sugar Pops, Sugar Smacks, Triple Snack and Vanilla Cream Krunch (Request For Admissions of Fact #10–34—Kellogg Company, dated December 4, 1972; Kellogg's Admissions of Fact #10–34, dated February 16, 1973).

General Mills: Alive, Big G Goodness Pack, Bran Wisps, Breakfast Squares, Buc Wheats, Buttercups, Carmel Puffs, Cheerios, Clackers, Cocoa Puffs, Cornados, Corn Bursts, Corn Total, Country Corn Flakes, Frosty O's, Fun Pack, Hi-Pro, Hot Toasted 40% Bran, Jets, Kaboom, Kix, Lucky Charms, Pick-A-Pack, Protein Plus, Smiles, Sugar Cones, Sugar Jets, Sugaroos, Total, Trix, Twinkles, Unsweetened Lucky Charms, Vital 7, Wackies, Wheat Hearts, Wheaties,

Wheaties Bran with Raisin Flavor Flakes and Wheat Stax (Request For Admissions of Fact #9–53—General Mills, Inc., dated December 4, 1972; General Mills' Admissions of Fact #9–53, filed February 20, 1973).

General Foods: Alpha-Bits, Bran Flakes, Bran & Prune Flakes, Cinnamon Raisin Bran, Corn Crackos, Corn Fetti, Corn Flakes & Blueberries, Corn Flakes & Peaches, Corn Flakes & Strawberries, Count Off, Crispy Critters, Fortified Oat Flakes, Frosted Rice Krinkles, Grape Nuts, Grape Nuts Flakes, Heart of Oats, Honeycomb, Oat Flakes, Pebbles, Pink Panther Flakes, Post Tens, Post Toasties, Puff Corn Flakes, Raisin Bran, Rice Krinkles, Sugar Coated Corn Flakes, Sugar Crisp, Super Orange Crisp, Top 3 and Treat-Pak (Request For Admissions of Fact #7–34—General Foods Corporation, dated December 4, 1972; General Foods' Admissions of Fact #7–34, filed March 6, 1973). **[75]**

Quaker: Cap'n Crunch, Cap'n Crunch's Crunch Berries, Cap'n Crunch's Peanut Butter Cereal, Diet Frosted Puffed Rice, Diet Frosted Puffed Wheat, King Vitaman, Life, Oat Flakes, Quake, Quaker Puffed Rice, Quaker Puffed Wheat, Quaker Shredded Wheat and Quisp (Request For Admissions of Fact #12–20—The Quaker Oats Company, dated December 4, 1972; Quaker's Admissions of Fact #12–20, dated March 14, 1973).

196. The failure to establish condition three is apparent from the very existence of these many different brands of cereals, each extensively advertised to extol their differences to the consuming public. And Dr. Markham testified that the degree of differentiation among RTE cereal products was such that his condition three has not been met (Tr. 38,433).

197. As Dr. Markham has testified, his model cannot be used to anticipate price leadership in differentiated product industries. "[H]eterogenous products imply a certain heterogeneity in prices; and that in and of itself vastly complicates any process of having—arriving at price patterns so parallel that they would be those one might expect in lieu of an overt agreement." In an industry where products are close substitutes, products will be purchased purely on the basis of price, and competitors are in a position to follow price leaders. In an industry with differentiated products, it is no longer clear what there is to be coordinated. Price can no longer be identified and isolated for particular products as something the sellers can focus on for purposes of coordination (Tr. 38,430–31).

198. The fourth condition:

> The elasticity of the market demand schedule for the output of the industry . . .

must not greatly exceed unity. If demand for the output of the industry is elastic because the oligopoly is only a segment of a larger monopolistically competitive market, the prices of closely competing products severely limit or possibly even eliminate the gains to be derived from adopting a price leader. Moreover, if demand for the output of the oligopoly is highly elastic, firms are not likely to adhere to the price leader's price if to do so would result in substantially less than capacity operations, since each firm could still stimulate its own sales considerably by lowering its price, even though all other firms met the new price (KX 104 at 186–87). **[76]**

199. An inelastic demand means that a price change will not significantly affect the quantity purchased (Tr. 27,809–10, 38,435–37). An industry at unity would be one, for example, where a 5% change in price would affect purchases by about 5% (Tr. 27,809–10).

200. While a coefficient of price elasticity of demand for the industry has not been developed on this record, it would appear that the demand for RTE cereal products is relatively price inelastic (Tr. 27,814, 28,000–01, 28,238). The uniqueness and price insensitivity of RTE cereals in relationship to other products has been described above (Findings 48–56). General Foods decisionmakers believed that consumer demand for RTE cereals is relatively price-inelastic (GFPF 7–509).

201. Respondents' contention (KPF 3–69; GMPF 2–44 thru 2–49; GFPF 7–628 thru 7–630) that RTE cereals are price elastic in relationship to all other breakfast foods is not supported in the record. To the contrary, the record establishes that the fourth condition is met.

202. The fifth condition:

Individual-firm cost curves must be sufficiently similar so that some particular price allows all firms to operate at a satisfactory rate of output. If, for example, the industry is composed of several high-cost low-capacity firms and several low-cost high-capacity firms, the resulting conflict in price and output policies cannot be resolved by adopting a price leader so long as all firms remain in the industry. Low-cost firms will not accept the price leadership of high-cost firms since there is a better option in the form of a lower price and a higher rate of output open to them (KX 104 at 187).

203. The record contains no cost studies. Complaint counsel (CPF 8–73) rely upon the testimony of Dr. Scherer to the effect that product technology and equipment were equally available to each respondent, raw materials (corn, oats, etc.) were purchased by each on the commodities market at the same quoted prices and each could utilize advertising agencies and procure advertising space and time on substantially equivalent terms (Tr. 27,814–16). Also, when estimating the costs of other producers, respondents assumed that the costs were equal to their own (CX–GM 171A; CX–GF 4039Z–91; CX–K 443A). This inference could be made, however, only when respondents were manufacturing similar products (Scherer 28,633).

204. In light of the large number of different products using different basic ingredients, different manufacturing processes and [77]different production lines, there is no basis for complaint counsel's assumption that condition five has been met. Complaint counsel themselves, in the course of meeting respondents' contentions as to Nabisco's profitability, assert (CRPF 11–62) that there is no basis for assuming Nabisco had the same capital-to-sales ratio as its competitors; that Nabisco could have different technology and older assets with resultant different capital intensities. And complaint counsel argue (CRPF 11–246) from the possibility that General Foods' cost per pound in relation to its competitors may be low.

205. Kellogg (KPF 3–71, 3–72) relies upon cost/sales figures derived from KX 97 which would show that General Foods was the high cost producer[22] followed by Kellogg and General Mills in that order.[23] General Mills (GMPF 2–52, 2–153) and General Foods (GFPF 7–632) rely on GMX 553 which shows that Kellogg was the high cost producer, followed by General Mills with unit costs as much as 25% lower than Kellogg's, and then General Foods with costs 33% lower than Kellogg's and 8% lower than General Mills'.

206. Complaint counsel (CRPF 114) would discount these exhibits because of their inconsistent results. The burden of proof as to costs, however, rests with complaint counsel and, while inconsistent, the only cost analyses in the record show that respondents' costs differed.

207. Complaint counsel (CRPF 8–115 thru 8–117) would also fault KX 97 and GMX 553, because costs as a percentage of sales shown by these exhibits could be accounted for by respondents having different selling prices. They would also fault GMX 553 because the firms differ in their relative order on costs depending upon whether the ratio used is cost/dollar sales or cost/pound sales. These objections, however, merely confirm the fact that respondents are selling different products, having different weights, at different prices; and that complaint counsel's inability to demonstrate that Dr. Markham's condition five has been met is a corollary of the fact that condition three has not been met.

208. Dr. Markham's widely regarded model of price leadership in lieu of overt agreement requires that all five stated conditions be met. The record clearly establishes that condition three (that each producer must view the output of all other firms as extremely close substitutes for its own) is not present and that complaint counsel [78]

[22] The President of General Foods Testified that General Foods was a high cost producer (Tr. 36,369), as did its Breakfast Foods Manager (Tr. 13,984).

[23] It cost General Mills more to produce Country Corn Flakes than it cost Kellogg to produce Kellogg's Corn Flakes (Tr. 17,748–49).

have failed to demonstrate the meeting of condition five (the similarity of the firm's cost curves). The RTE cereal industry, therefore, has not been shown to be one where price leadership in lieu of overt agreement is to be anticipated.

Dr. Markham's model, well-reasoned as it may be, is, of course, merely an economic theory as to what may be expected. Even if all conditions of the model had been met, it would not substantiate a finding that the respondents in fact coordinated prices by reason of price leadership and price followership. Complaint counsel would still be required to prove that situation by the acts and practices of the individual respondents. And they are not precluded from that attempt because the industry does not fit the model. Nevertheless, respondents' acts and practices, as evidenced, must be evaluated in light of the characteristics of the industry and the inconsistencies of those characteristics with the conditions of Dr. Markham's model.

It is alleged that respondents, under the principles described above, tacitly colluded or arranged to avoid a wide range of competitive activities that would threaten to reduce prices and the resultant monopoly profits which respondents allegedly achieved. We shall now consider the various competitive activities alleged by complaint counsel to have been subverted by respondents to following "the rules of the game" (CP 136–38).

B. *Monitoring of Competitors' Activities*

209. Each respondent closely monitored the activities, including pricing actions, of all other RTE cereal producers. Each respondent published and delivered list prices for its RTE cereal products to customers in advance of the actual price increase dates (Tr. 7522, 7841–42, 13,221, 13,705; *See* CX–K 766 thru 869; CX–GM 361 thru 504; CX–GF 214 thru 320). Through its monitoring efforts, each respondent knew, usually in advance of the effective date of the price increase, when, and the extent to which, another respondent was changing prices (Tr. 7521, 7887, 14,250).

210. Respondents used several methods for monitoring purposes, including their own personnel and market reporting services such as A.C. Nielsen and Selling Area Marketing, Inc. (SAMI) (Tr. 7472–81, 8075–76; CX–K 7B, 11C, 13A, 15A, 16, 20B, 24B, 25B, 26B, 27B, 37B, 38A, 48B, 76, 88C, 916A; KX 14; CX–GM 93, 281; CX–GF 1593). Such monitoring allowed each firm quickly and accurately to obtain detailed information about the actions of the others in such areas as pricing, new product introductions, product changes, advertising, promotional programs and shelf space activities. This information,

along with other considerations, was used by each respondent in planning its future conduct with respect to the development, marketing, sales and pricing of RTE cereals (Tr. 7523, 7525–27, 11,841–43, 12,319, 12,321, 12,730–31, 12,737, 12,927–28, 13,017–19, 13,045, 13,200, 14,172, 14,231–35, 14,270, 14,282, 14,346, 14,364, 17,336–38, 18,010; CX–K 944C; CX–GM 81). **[79]**

211. Such monitoring of competitors' activities is consistent with alleged efforts to coordinate competitive practices, including pricing. It is also consistent with an effort to react in a competitive fashion to the competitive activities and strategies of others in the industry (Tr. 38,433–35, 38,606).

212. For example, General Foods' technical research department monitored competitors' new and established product activities in order to remain aware of technical advances (Tr. 13,641–42).

213. In order to continually assess the competitive environment, General Foods purchased information on other companies' activities and on consumer preferences from A.C. Nielsen, SAMI, Market Research Company of America (MRCA), and the National Purchase Diary (Tr. 14,349).

214. Data received by General Foods from MRCA and National Purchase Diary gave profiles of just what categories of persons purchased particular products. This allowed researchers to determine the number of families purchasing a product, the number and frequency of purchases, the demography of buyers and an analysis of purchasing patterns over time (Tr. 14,364–65).

215. General Foods carefully monitored and tried to assess the impact of all competitive products on its line of RTE cereals. The introduction of a new product by one of its competitors would inaugurate an in-depth analysis of that product. The technical department would undertake to analyze the cereal as to its ingredients and its claims, and then perhaps run a consumer test. The new product's price was considered to have a potential impact on the market and was, therefore, compared to established products' prices. General Foods' researchers would ask Nielsen to track distribution of the product in the United States, as well as its sales and pricing trends (Tr. 14,219–21).

C. *Price Competition*

Complaint counsel assert that elimination of price competition in the industry is shown by the industry's high rate of return and price/cost margins, both of which were substantially higher than those of most other manufacturing industries; and by an analysis of

price trends showing that the prices for RTE cereals rose faster than those for other food products and that price decreases for RTE cereals were practically non-existent (CPF 8–9). First, however, we turn to the more direct evidence bearing on respondents' pricing activities.

216. We first consider the methods whereby the respondents set their prices. Top executives of all respondents have denied the [80] existence of any agreement among the respondents concerning price (Tr. 29,918, 35,462, 35,815, 36,552). Such testimony of Kellogg and General Mills officials falls within that which I am bound to accept at face value (*see, supra,* pp. 13–16). And, of course, if Kellogg and General Mills had no such agreements with General Foods, General Foods had no such agreements with Kellogg or General Mills. Unless overcome by more persuasive evidence, I am required to accept such testimony as accurately describing the situation.

1. *Pricing Policies*

(a) Kellogg

Since Kellogg is the alleged price leader, we shall first consider its method of pricing.

217. Kellogg has not set prices in order to maintain a profitable price structure for its RTE cereal competitors (Tr. 29,928).

218. Among the most important factors considered in Kellogg pricing decisions were production costs. During the period covered by the complaint, Kellogg conducted pricing meetings attended by senior executives at which it considered the basic problem of what to do about increasing costs, including raw materials, packaging, labor and overhead (Tr. 29,913–14, 29,993, 30,102, 30,115). The same considerations entered into Kellogg's determinations of the appropriate prices for new products it was introducing (Tr. 13,200–01).

219. Kellogg had a guideline for gross margins on RTE cereals, as well as a target net profit figure (Tr. 30,060, 30,063). Through experience, Kellogg had learned that maintenance of its gross margin guidelines for individual brands would generate sufficient revenues to cover costs and still meet its net profit guideline for each brand (Tr. 30,006). In these pricing meetings, therefore, it was understood that price increases should maintain profit margins on the products (Tr. 30,073–74).

220. Decisions to increase price generally covered a group of cereals and did not always include those cereals which were experiencing the largest cost increases. The final decision to increase prices was based primarily on the "total amount of revenue" that

would be generated if the increases were taken. At the same time, an analysis was made on a product-by-product basis (Tr. 30,103–04). The Kellogg executives considered the impact that the changes in input costs would have on the gross margins for particular brands (Tr. 29,914). Some brands fell short of margin guidelines and others exceeded them (Tr. 30,013–14). Products chosen for the largest price increases were those that were expected to maintain their sales pattern despite increased prices (Tr. 30,063–69). [81]

221. Both Kellogg's market research department and its comptroller's office prepared memoranda for use at the pricing discussions. The comptroller's memoranda detailed, on a product-by-product basis, the present and proposed Kellogg selling prices, the present and proposed retail selling prices, the date of the last price increase, the package size, the proposed price increase per dozen, the calculated percentage increase, and the selling prices of other producers' brands; also, the amount of additional revenue that would be generated if the particular price increases were made (Tr. 12,936, 30,070–74, 30,103–04).

222. When cost increases were incurred, Kellogg could either maintain its price on a particular brand and accept a reduced margin of profit or raise the price of the brand.[24] If Kellogg felt that a prospective price increase would have a sufficiently adverse impact on sales, it would not increase price, but would accept a lower margin. On the other hand, if Kellogg felt that a price could be increased without a significantly adverse effect on sales, the price of the brand in question would be raised (Tr. 29,914, 29,917, 30,068).

223. To estimate the potential effect of a price increase on the sales of a particular brand, Kellogg examined the prices of products which competed with that brand. Kellogg recognized that pricing a brand above competition could adversely affect sales (Tr. 29,919). For brands with direct competitors, Kellogg had to exercise care in raising prices. For brands with no direct competitors, Kellogg had greater pricing flexibility (Tr. 30,059).

224. When attempting to estimate the impact of a price increase on sales, Kellogg considered the recent sales trend of the brand in question, sales trends of competitive brands and the recent pricing activity of competitive brands (Tr. 12,933–34, 12,941, 30,102). It also considered what competitors might do if Kellogg changed its prices (Tr. 30,056).

225. Kellogg considered the effect that changes in the wholesale prices of its cereals might have on retail prices. Kellogg was

[24] At times, Kellogg was able to preserve the margin of a particular brand in the face of rising costs by substituting acceptable less costly inputs (Tr. 29,915).

concerned particularly about establishing wholesale prices that would lead to retail prices that would surpass "psychological barriers" (such as fifty cents per box, or one dollar per box), which might present a significant deterrent to sales (Tr. 12,939, 29,917). [82]

226. When sales of a particular brand had fallen or had not grown as expected, Kellogg might consider a price reduction. The deciding factor was whether the price reduction would increase sales volume sufficiently to offset the resultant lower per unit margin. The purpose of any price reduction, like any price increase, was to increase profits (Tr. 29,920).

227. List price decreases, however, were seldom used. Coupons were the most frequently used means by which Kellogg effected short-run price savings on selected RTE cereals (Tr. 13,041). Unlike trade deals, which are short-term price reductions to grocers, Kellogg felt assured that coupon price reductions would reach the consumer (Tr. 12,545). Kellogg believed that price reductions did not stimulate sales among regular heavy users of a particular brand, whereas couponing effectively granted price reductions to the marginal consumer who might not otherwise purchase the couponed brand (Tr. 12,289, 12,545, 29,926–27).

228. If competitors did not follow a Kellogg price advance and the resultant price differential adversely affected Kellogg's sales, consideration would be given to taking appropriate action (Tr. 30,106–07).

229. In 1966, Mr. Charles Tornabene, then Kellogg's Vice President and Domestic Sales Manager, made a speech at an annual regional meeting of Kellogg officials. In it, he described Kellogg as the leader in the industry (CX–K 549L) and stated:

> A leader should do all in its power to build and expand its industry sales and avoid any steps which will drag the industry down. A leader must maintain a profitable price structure within the industry—both for its members and its distributors.
>
> * * * * * * *
>
> Only a strong company can afford to exercise restraint when it is needed to keep an irritable condition from deteriorating into a war that no one wins. Only a strong company can set the pace that provides a favorable climate for a strong and growing industry. Only by disciplining ourselves can we set the example for a disciplined industry (CX–K 540M, Q).

He also quoted with approval the comment of one whom he identified as a well-qualified observer: [83]

> [T]here is no area in the food business today in which the true qualities of industry leadership are more aptly displayed than in the cereal industry where Kellogg provides strong and consistent leadership in building and expanding the profitable

climate of true growth, virtually free from destructive pricing and promotional practices (CX–K 549P).

230. In addition, Mr. Tornabene stated that "Kellogg has a long history of consistently resisting price cutting and gimmicks and withstanding competitive pressure in these areas;" and that "where it was necessary to participate—overwhelmingly—in order to put an end to destructive practices," Kellogg has done so and would continue to do so (CX–K 549M).

231. This speech reflects Mr. Tornabene's and Kellogg's belief that, as the industry's leading competitor, it would not serve Kellogg's interest to engage in destructive pricing and promotional wars. It does not indicate the existence of an agreement between Kellogg and its competitors; and even if it did, Mr. Tornabene's statement could not be used against the other respondents as evidence of a conspiracy since that statement was not made in furtherance of a conspiracy, and the existence of a conspiracy has not otherwise been established (see, *supra,* p. 19).

232. In the face of Kellogg's President's sworn testimony that Kellogg has not set prices in order to maintain a profitable price structure for its RTE cereal competitors (Tr. 29,928), and in the absence of any other evidence that would tend to show that Kellogg acted to help its competitors realize profits, Mr. Tornabene's generalization in this area is entitled to little weight. Contrary to the factual conclusion complaint counsel would draw from Mr. Tornabene's statement, both General Mills and General Foods were constrained by Kellogg prices from raising prices on their own products.

(b) General Mills

233. As with Kellogg, a primary determinant of price, both for new and established General Mills products, was input costs (Tr. 16,604, 16,609, 35,524).

234. General Mills also considered the prices of competitive products in reaching pricing decisions. This was to avoid pricing its products out of line with competition, which might result in deterring sales (Tr. 16,604–10, 35,653–54). **[84]**

235. General Mills considered the past pricing activities of General Foods and Kellogg. Pricing data considered included pricing histories, analyses of price changes by all three respondents, including price change effective dates, brands affected and the amount of revenue generated by increases (Tr. 17,331–34; CX–GM 27, 168, 2007B, 2012A).

236. General Mills had its field personnel promptly report competitive price change information (CX–GM 186, 194, 281, 283). Price changes were often reported by telegram (CX–GM 199, 201, 205, 249, 250–51).

237. By 1967, General Mills' average price per pound had risen by $.095 over 1962, the highest absolute increase of the six largest RTE cereal companies. By 1970, General Mills' average price per pound had increased by $.19, or 52.1%, a much larger increase than that of any other major RTE cereal manufacturer. From 1968 on, General Mills' average price per pound was higher than that of any of its competitors except for Quaker (GMX 560A; GFX 1151, 1152).

238. Because it saw itself in a premium priced position, General Mills was reluctant to initiate desired price increases for fear of substantial sales losses. Reporting to the head of General Mills' cereal department in March 1967, Mr. Schulze (then in charge of Adult Cereal Marketing) concluded that General Mills was "not in a position to advance prices" on its adult cereals because of three factors: (1) recent price increases on these cereals; (2) current prices on these cereals were equal to or above their "direct competition"; and (3) "Kellogg is still the clear leader in the cereal industry, and with our current premium-priced position, we do not feel that we could lead a price advance" (CX–GM 280A).

239. The competitive constraints brought to bear by General Mills' perceived position as a premium priced manufacturer are exemplified in pricing decisions involving Trix and Lucky Charms. These brands were recognized as "premium priced products." In March 1967, Mr. Bodeau, a General Mills official, recommended against a price increase on these brands because they were already priced higher than most presweets. "We believe increasing our premium difference would be unwise and result in volume losses on these products" (CX–GM 278B).

240. The prices of Trix and Lucky Charms were not increased at that time. The price of Trix was not increased until November 1967 (CX–GM 477); and Lucky Charms' price was not raised until January 1969 (CX–GM 487). In the interim, General Foods had increased the prices of Honeycombs and Super Sugar Crisp in June 1967 (CX–GF 304), Kellogg had increased the price of Sugar Smacks and Sugar Pops in August 1967 (CX–K 858), and General Foods had again increased the price of Super Sugar Crisp, along with Alpha-Bits, in September 1967 (CX–GF 305).

241. In analyzing the possibility of raising prices for its "child cereals" in mid-1967, General Mills compared its prices with [85] those of its competitors and evaluated the "price changing history."

It concluded that, because it expected to lose too much volume if it raised prices, while its major competitors did not, there was "no price advance possibility unless our major competitors initiate a change" (CX–GM 278A, C–D).

242. It is concluded that the record reflects genuine independent business reasons why General Mills did not originate price changes to a greater degree than it did and followed price increases of its competitors.

(c) General Foods

243. Pricing questions arose at General Foods as a part of the annual budgeting and marketing planning process. Costs and market conditions were evaluated and pricing assumptions were factored into annual product plans. In addition, decisions were often made during the year, as necessary (Tr. 13,984, 36,396, 36,400–01).

244. General Foods, as did Kellogg and General Mills, viewed input costs as a prime determinant in its pricing decisions (Tr. 13,984, 36,400–01; CX–GF 4039Z–23). As a much smaller producer than Kellogg and General Mills, General Foods believed that it had smaller profit margins and that it was under greater cost pressures and urgencies to increase prices in response to cost increases (Tr. 13,984). General Foods, therefore, sought opportunities to increase prices (Tr. 36,369, 36,574–76, 36,400–01).

245. Nevertheless, General Foods could not unilaterally raise its prices on brands which faced direct competition. It believed, for example, that initiating price advances on Post Toasties or Post Raisin Bran which put those products at a price disadvantage vis-a-vis their direct competitors (Kellogg's Corn Flakes and Kellogg's Raisin Bran, respectively) would result in significant share swings away from the Post brands (CX–GF 2022E, 3000Z–23c, 4039Z–79). Despite increasing costs, General Foods had to wait for larger companies to move before it could act to meet its own profit margin goals (Tr. 13,984). Accordingly, a 1967 General Foods Task Force recommended that General Foods "[a]ssume the position of a follower in pricing action that occurs in the industry recognizing that *price increases will not be followed automatically unless such action is justified by cost*" (emphasis supplied) (CX–GF 4039P).

246. General Foods' overall policy was to "Price directly competitive generic brands, *i.e.,* Corn Flakes, Bran Flakes equal to prime competition on a price per ounce basis" (CX–GF 4039P). Further, its intent was to price such cereals as high as possible within the constraints imposed by its competitors. It became a follower rather

than a leader (CX–GF 17L, 418A, 1408E, 2033J, 3000Z–193, Z–216, 4033H). **[86]**

247. The record is replete with instances where General Foods' policy to follow rather than initiate pricing action was implemented with respect to particular brands, *e.g.,* General Foods' Raisin Bran's relationship with Kellogg's Raisin Bran (CX–GF 345E, 440J, 1996C); General Foods' Alpha-Bits' relationship with Kellogg's Froot Loops and General Mills' Trix and Lucky Charms (CX–GF 1382U); General Foods' Pebbles' relationship with leading flavored brands (CX–GF 1420C, 2021H); General Foods' Bran Flakes' relationship with Kellogg's Bran Flakes (CX–GF 1989B); General Foods' Sugar Crisp's relationship with Kellogg's Sugar Smacks (CX–GF 1410L). General Foods' Post Toasties' relationship with Kellogg's Corn Flakes (CX–GF 2022E, 2024C); General Foods' Pink Panther Flakes' relationship with "other kid presweet brands" (CX–GF 1435Z–38); General Foods' cereal assortments' relationship with Kellogg's cereal assortments (CX–GF 2008B, 2009C).

248. General Foods' policy was to "[r]ecognize through pricing any unique attribute or quality which a Post product offers the consumer, *i.e.,* higher than average prices will be charged for products which are unique in convenience or benefit" (CX–GF 1300M). However, even these relatively exclusive brands had to be priced "within a generalized area of reason relative to other cereals" (Tr. 36,403). As stated in its 1967 Task Force report, General Foods sought to "[p]rice brands having no direct competitor to maximize gross margins after recognizing the retail price range for brands within the same category" (CX–GF 4039Q).

249. General Foods' 1967 Task Force sought to raise the profit margin of brands such as Post Toasties, Bran Flakes, Raisin Bran and Grape Nuts Flakes, which were subject to direct competition (CX–GF 4039Z–104). However, it was unsuccessful in this effort (CX–GF 3000Z–23c). General Foods, despite its desire to avoid initiating price increases, was forced to initiate a price increase on Raisin Bran in June 1969. Kellogg did not increase the price of its Raisin Bran until December of that year (CX–GF 3000Z–23c). The consequent price disadvantage resulted in a substantial sales swing to Kellogg (CX–GF 3000Z–23d). This experience was cited by the 1971 Task Force as evidence "that brands with direct competitors . . . witness volume swings with price differentials. . . ." Consequently, the Task Force recommended that, on such products, General Foods should "follow the market leaders or direct competitor whenever possible" (CX–GF 3000Z–193).

250. General Foods has evaluated the possibility of lowering

prices—the issue being whether price reductions would generate sufficient additional sales to offset the lower margin General Foods would receive on each sale (CX–GF 571K, S, Z–1, Z–6, Z–15 thru Z–17, 4039Z–106, Z–109). A 1970 report was particularly interested in, and analyzed, the pricing alternatives (upward and downward) for Post Toasties (CX–GF 2022E).

251. After an internal assessment, a member of the 1971 Task Force rejected the idea of an across-the-board price reduction, [87] because it would require an unrealisitc increase in sales volume to offset the decreased margins resulting from the price reduction.

> Given our current margin situation a reduction in price (as a marketing strategy) does not appear to be a realistic opportunity for Post (CX–GF 3000Z–193).

Two price increases on Post Grape Nuts, in June 1969 and in November 1970, caused substantial share losses (CX–GF 3000Z–23c, Z–180).

252. Categories in which General Foods faced direct competitive pressure produced substantially lower variable gross profit rates than categories in which competition was less direct. A low variable gross profit rate in the corn flakes category was attributed to "the reluctance of Kellogg's and Post to make major pricing moves" (CX–GF 3000Z–68). General Foods lowered its price on Post Toasties to meet a Kellogg price decrease on Corn Flakes in July 1971 (CX–GF 3000Z–121, Z–177).

253. General Foods' overall margins were lower in FY 1973 than in FY 1969 (CX–GF 3000Z–261). This situation was attributed to three factors, the first two of which were:

> [Post Toasties] price decline.
>
> Inability to take planned pricing action (CX–GF 3000Z–179).

These factors reflect competitive constraints that affected General Foods' pricing decisions (CX–GF 3000Z–261).

254. General Foods' price per pound was less than that of the other respondents (CX 106D, F; GFX 1151–52).

255. It is concluded that the record reflects genuine, independent business reasons why General Foods did not originate price changes to a greater degree than it did and followed price increases of its competitors.

2. *Coordination of Prices*

(a) Brand Price Coordination

Dr. James Green, formerly an economist with the Commission, was presented by complaint counsel to testify with respect to price [88]coordination of particular competitive products. He testified to this end for seven days (Tr. 9687–10,501). His direct examination extended for five days (Tr. 9687–10,227).

256. Dr. Green, on the basis of his own examination of documents in the possession of complaint counsel, selected products for comparison that he thought were highly substitutable (Tr. 9837, 9897, 10,470). While Dr. Green purported to find pricing coordination among a number of products, a study of his analyses reveals that a pattern consistent with coordination was established only with respect to three sets of products—Kellogg's Corn Flakes and General Foods' Post Toasties; Kellogg's and General Foods' Raisin Brans; Kellogg's Sugar Frosted Flakes and General Foods' Sugar Coated Corn Flakes (Tr. 9,833, 10,130–42, 10,170–83; CX 341; *see, supra,* Finding 106).[25]

257. Dr. Green's failure to present evidence for additional sets of products, consistent with coordination, pricing agreement or price leadership and followership, is reflected by a number of factors.

258. Dr. Green loosely defined "coordination" in terms of price levels and the amount of price change, and the time lags between price moves of the pairs of products being studied (Tr. 9,833–42). In evaluating price changes, however, he disregarded package size changes of products being compared which effectuated changes in cost per ounce of those products (Tr. 9789, 10,232–33, 10,259–60). Also, because of package size changes, the witness abandoned efforts to compare price levels and relied upon the length of time lags (Tr. 10,082, 10,085, 10,088). The witness at times relied on timing of price changes, irrespective of price levels (Tr. 10,291–92). Dr. Green finally conceded (Tr. 10,343) that his conclusions and testimony as to coordination had to do with the timing of price changes, not with price levels. [89]

259. However, time lags varied greatly in length, from relatively short periods to periods as long as four to six months and even eight to nine months and, in some instances, there would be no response at all (Tr. 9941, 9964, 9990, 10,061, 10,064, 10,081, 10,087, 10,142, 10,154). Price changes varied so in timing that Dr. Green could not

[25] Other products compared by Dr. Green, but where pricing coordination was not established, include General Foods' Grape Nuts and Quaker's Life (Tr. 9893–9947); General Mills' Cocoa Puffs and Kellogg's Cocoa Krispies (Tr. 9949–9967, 10,377–96); Kellogg's Product 19 and Special K and General Mills' Total (Tr. 9967–9990, 10,355–76, 10,418–21); General Mills' Frosty O's and General Foods' Alpha-Bits (Tr. 9992–10,000, 10,422–31); Kellogg's All Stars and General Foods' Alpha-Bits (Tr. 10,003–09); General Mills' Wheaties and General Foods' Grape Nuts (Tr. 10,016–64, 10,396–410); General Foods' 40% Bran Flakes and Kellogg's 40% Bran Flakes (Tr. 10,065–88); Kellogg's All Bran and Nabisco's 100% Bran (Tr. 10,092–122); General Mills' Trix and Kellogg's Froot Loops (Tr. 10,143–47, 10,432–44); Kellogg's Rice Krispies and General Mills' Cheerios (Tr. 10,149–55, 10,276–343).

tell whether a price change on a product was in response to a prior one on a different product, or was the beginning of a new price round (Tr. 9941–45). Dr. Green disregarded situations where an increase in price was accompanied by an increase in the size of the box, as he felt unable to make a judgment in such a situation (Tr. 10,384, 10,395). Neither did he take into account situations where a price change in one product was preceded or followed by a box size change in another, or a size change in one product was not responded to by a competitive product (Tr. 10,426–30).

260. Apart from the above recitation of some of the defects in the witness' analyses, I have carefully studied Dr. Green's presentation on the issue of brand price coordination. Except for Kellogg's Corn Flakes and General Foods' Post Toasties, Kellogg's and General Foods' Raisin Brans, and Kellogg's Sugar Frosted Flakes and General Foods' Sugar Coated Corn Flakes, there is no evidence of price uniformity, maintenance of pricing levels, or pricing responses consistent with a pricing agreement or arrangement among respondents or with price leadership and followership.

261. In addition to what he presented at the hearings, Dr. Green had prepared comparisons of other sets of products which he thought were comparable. These comparisons were not presented at the hearings because, in Dr. Green's opinion, they did not reveal any apparent pricing coordination (Tr. 10,249).

262. The record, therefore, lacks probative evidence of price coordination between particular brands other than the three sets of products identified above. To the contrary, the record tends to evidence a lack of such brand price coordination or parallel pricing movement.

263. The extent to which the record shows price similarity between the two brands of corn flakes, the two brands of raisin bran and the two brands of sugar frosted or sugar coated corn flakes does not establish any coordination in avoiding price competition. Price similarity, even identity, is to be expected for very similar products even under competitive conditions (Tr. 10,462, 27,813, 28,517, 28,642, 38,371–73, 38,579).

(b) Pricing Rounds Coordination

Complaint counsel contend that "respondents under Kellogg's leadership, coordinated their pricing behavior by engaging in a **[90]** pattern of price leadership in lieu of overt collusion" (CPF 8–10). Starting with Dr. Markham's model which sets forth the conditions under which such a situation may be anticipated (CPF 8–61 thru 8–74, 8–82; CRPF 8–87 thru 8–122), which I have already found does

not fit here (*supra,* Findings 186–208), complaint counsel rely primarily on an analysis of pricing rounds in the industry covering 1965 through 1970, prepared and testified to by Dr. Scherer (CPF 8–83 thru 8–84). As described by complaint counsel, "A price round is a series [or group] of list price changes that occur when a firm changes the price of two or more regular size branded products" (CPF 8–83).

Before examining in detail the 16 price rounds in question, it is appropriate to compare some of the basic concepts involved in price leadership with what Dr. Scherer's price rounds profess to show.

264. We start with condition three of Dr. Markham's analysis—the requirement that the products of the respective firms be viewed "as extremely close substitutes." This requirement is obvious since we are dealing with *price* leadership and it is necessary to have products sufficiently similar so that *price* is a primary element and can be coordinated by leadership and followership. As already found, except for three sets of products, Kellogg's Corn Flakes and General Food's Post Toasties, Kellogg's and General Foods' Raisin Brans, Kellogg's Frosted Flakes and General Foods' Sugar Coated Corn Flakes, there is no evidence of price uniformity, maintenance of pricing levels or pricing responses at a product level consistent with price leadership and followership.[26]

265. The 16 price rounds, as presented by Dr. Scherer and relied upon by complaint counsel, do not take prices into account other than for the fact that price changes were made. Levels and magnitudes of price changes are ignored. Indeed, the price round presentation does not even demonstrate that "lead" price changes on particular products were followed by price changes on what may be termed directly competing products. To the contrary, the amount of price change varied by product, and the types of cereals involved in one company's price change varied from those in the subsequent price change of other companies. In short, there is no correlation of individual products or individual product prices in Dr. Scherer's price rounds. Indeed, individual products and prices are not even evaluated. There is, therefore, no showing of correlation of any brand prices or price differentials as to particular brands. **[91]**

266. General Mills' overall prices in relationship to pounds of RTE cereals sold increased far more rapidly than those of the five other largest factors in the industry:

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[26] Dr. Scherer conceded that, for most products, "there seems to be very little pattern in the relationships between changes in the price of one product relative to changes in the price of another" (Tr. 27,922).

AVERAGE PRICE PER POUND SOLD[27]
($)

Year	Kellogg	General Mills	General Foods	Quaker	Ralston	Nabisco
1962	.392	.365	.321	.485	.288	.324
1966	.445	.440	.398	.524	.355	.355
1967	.463	.460	.401	.551	.366	.370
1968	.474	.482	.392	.581	.355	.378
1969	.496	.513	.414	.604	.382	.398
1970	.522	.555	.426	.633	.388	.408
Increase 1962–70	.130	.190	.105	.148	.100	.084
% Increase	33.4	52.1	32.8	30.4	34.7	25.9

Neither Kellogg nor General Foods matched General Mills' overall price increases.

267. This disparity in relative price increases for General Mills vis-a-vis, Kellogg and General Foods cannot be wholly attributed to the possibility that, during the period in question, General Mills may have introduced new, more expensive brands and discontinued older, less expensive brands. A comparison of pricing levels limited to brands that were in existence in 1961 shows that General Mills increased these prices overall more rapidly than did its competitors (Tr. 31,702; KX 102).

268. None of the 16 "rounds" of price changes involved list price changes of all of any company's brands (Tr. 27,915; CX 1004). Dr. Scherer originally explained the import of his price round presentation as follows (Tr. 27,828–29):

> Now, it is my inference, I don't find exact documentary support for this inference, but it is my inference that what is going on is a kind of averaging process. That is to say, one goes into a price round with the expectation of raising a certain amount of [92]additional revenue through the price increase. And one chooses, therefore, a group of products that through which by raising the price, one can, if all goes well, raise that additional amount of revenue.
>
> Now, if one is alone in this price increase, then the products who prices have been increased are liable to suffer some erosion of market volume. But, if everybody goes up on a package of products, if everybody takes part in the round and increases prices on a group of products, then the following will happen:
>
> After the round some products prices will not have been increased. Some products prices will have been increased. There will be some tendency for the demand to flow towards the products whose prices have not been increased. But if everyone goes up by more or less the same percentage of his total volume, the gainers will more or less on average be offset by the losers. That is to say, the products whose prices have been

[27] Derived from GMX 560A.

raised will now be relatively high priced relative to the products whose prices have not been raised.

Each firm will have products whose prices have been raised. Each firm will have products whose prices have not been raised, and on the average, the gains and losses of patronage in this type of group price increase approach will average out if, in fact, the companies tend to move on about the same fraction of their product line. Over the average.

269. Dr. Scherer's approach, therefore, was not to confirm or establish a situation of price leadership where price was an essential element of product competition, but rather to attempt to explain why it was not necessary for the parties to engage in such a practice.

270. Except for a period when General Foods was competing on the basis of the overall General Foods name, all respondents have competed on an individual brand basis, particularly against the competing brands in the pertinent segment or, on an even narrower basis, against individual directly competing brands. I cannot accept, in the absence of direct proof, Dr. Scherer's inference that respondents, pursuant to agreement or price leadership and followership, are willing to suffer an erosion of sales on particular **[93]**brands by raising their prices in the absence of price increases of their direct competitors, in anticipation of securing greater sales on brands whose prices are not increased.

271. Brand competition is much too intense and complicated to assume that, by averaging out the price increase to constitute an equal percentage of total volume, competitive price differentials will not affect different products differently. Therefore, I reject Dr. Scherer's unsupported inference as to the nature of the price leadership and followership existent among respondents. In any event, an analysis of the price rounds demonstrates that they are inconsistent with any such percentage agreement or coordination.[28]

272. In order to have price leadership, the parties must understand the purport of each other's actions. As Dr. Scherer has written:

Leadership is a means of communicating, and the process may break down if some messages go unheeded, so that one never knows what the reaction to a new price announcement will be (F. Scherer, *Industrial Market Structure and Economic Performance* 168 (1st ed. 1970)).

273. Keeping this principle in mind, it is noted that Dr. Scherer included in his analysis only "price advances on more than one product unaccompanied by package changes" (Tr. 27,903). According-

[28] Even if percentage of the line change coordination had been established, this would have been insufficient proof of price coordination in the absence of a showing of the levels of price change.

ly, he excluded all list price changes by any respondent that applied to only one brand (Tr. 27,827),[29] as well as price moves that were accompanied by package size changes (Tr. 27,903). Dr. Scherer explained his reasons for such exclusions:

I infer from what I have seen of the processing technology that it is a little [94]bit difficult mechanically to change a package size. So not uncommonly only one product's package size is changed at a moment in time and then there may be a price increase accompanying it. And by and large I found that in the company monitoring documents not much attention was paid to those single package size changes accompanied by a price change.

I also observed that by and large not much attention was paid to single price changes, single product price changes even without a package size change, so I came to the conclusion that occasional single product price changes were really not a part of the standard price leadership-followership pattern. And so I have, for the most part, excluded single product moves from my analysis (Tr. 27,826–27).

* * * * * * *

I excluded price moves that were solely accompanied by package changes. That is to say, if there were no changes of packages, package sizes, in the price change, then I excluded that as a round, . . .

The reason I did that is this: That very frequently one finds on package changes that it is ambiguous whether a price change has been effected or not. A package change will take place, a price change may take place simultaneously on the price of the package. And it is a little bit ambiguous because it depends upon the relationship of the package increase or decrease relative to the price increase—the case price increase or decrease, whether the effective price has been raised or lowered.

And so I found in company documents that the companies had a little bit of trouble analyzing just what was going on and how to interpret these package changes, and so I excluded them (emphasis supplied) (Tr. 27,830–31).

* * * * * * *

Q. And are you saying that because a competitor may have difficulty understanding the market implications of a price move of a [95]competitor, that is justification for excluding the price move as a round?

* * * * * * *

THE WITNESS: The word I have trouble with is justification. In that question. That implies some universal set of criteria that aren't defined.

It was my best professional judgment that, indeed, those kinds of situations provided much more ambiguous signals than other kinds of situations, and so therefore I did so exclude them.

* * * * * * *

Q. When you say "ambiguous signals," you mean between and among competitors?

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[29] An analysis that covered such price changes would have been instructive since it might reflect the competitive situation on a one-to-one basis of directly competitive products. Of course, Dr. Green had already failed to show a correlation in individual brand pricing (*supra*, Findings 255–61).

A. Price leadership is a method of signalling, and presumably you are signalling between and among competitors, yes.

274. Thus, rather than attempting to account for or reconcile pricing actions which appeared inconsistent with the communication process requisite for price leadership and followership among respondents, Dr. Scherer chose to ignore them.

275. Still another requisite for price leadership in lieu of overt collusion, to be kept in mind when analyzing the price rounds, is that all respondents must cooperate (CPF 8–7).

276. As part of its price leadership theory, complaint counsel assert that Kellogg is the price leader and that a typical price round begins with Kellogg's announcement that it plans to increase prices on a certain group of products on a particular date (CPF 8–10, 8–85). These Kellogg price increases, according to complaint counsel, were expected to be, and in fact were, matched by the other respondents so that approximately the same pricing relationship existed between the firms after the increase as had existed before the increase (CPF 8–21, 8–85). As previously noted, Dr. Scherer's price rounds analysis does not attempt to demonstrate a brand price relationship. But in our evaluation of the rounds, we must keep in mind the assertion that Kellogg is the price round leader and that the other respondents are the followers. The requirement that the followers follow has been expressed by Dr. Scherer:

Whatever the reasons for a firm's acceptance as price leader, its leadership must be **[96]**followed consistently and with near unanimity if the industry is to make the most of its market opportunities. Leadership is a means of communicating, and the process may break down if some messages go unheeded, so that one never knows what the reaction to a new price announcement will be (F. Scherer, *Industrial Market Structure and Economic Performance* 168 (1st ed. 1970)).

277. Still another requisite of complaint counsel's price leadership-price followership theory is that the price followers "change their prices in consonance with those of the leader" and "thereby reduce . . . the duration of any significant price differentials" (CPF 8–11). This condition is obvious because, to the extent there are prolonged delays in reacting to the price leader, there is an absolute failure of price coordination. Also, from the point of view of the leader, the longer the delay, the less assurance it has that the other firms will follow and this can cause a breakdown of the system. Further, from an evidentiary point of view, the longer the delay by the follower in making its price change, the less clear it is that its price change is in response to that of the leader rather than in response to other competitive conditions (Tr. 32,499). Time delays in

following price changes by the leader, therefore, are important considerations in evaluating Dr. Scherer's price rounds.

Analysis of Pricing Rounds

278. Prior to Dr. Scherer's Round 1, Kellogg, on January 1, 1965, changed prices on 23% of its line (CX–GM 168).[30] The price increase was accompanied by a package size change and so was one of those excluded by Dr. Scherer as "ambiguous" (Tr. 27,830, 28,470). Neither General Mills nor General Foods took any action in response to Kellogg's January 1, 1965, price change (Tr. 28,470).

Round 1

279. Prior to April 8, 1965, Kellogg announced price increases effective April 24, 1965, on cereals representing 24% of its RTE cereal sales volume (CX–K 852; CX–GM 168). On April 8, 1965, General **[97]**Mills issued a price list with increases effective that date on 58% of its line, but allowed customers to purchase at old prices until May 7 (CX–GM 168, 464). General Foods then advanced 28% of its product line, effective May 14 or May 17, 1965 (CX–GF 295; CX–GM 168)[31] Dr. Scherer's analysis for 1965 shows that the "comparable dollars generated" by General Mills' pricing actions were over 120% higher than Kellogg's and 43% higher than General Foods' (GMX 105).

280. Thus, there is no coordination as to share of line moved or comparable dollars generated in Round 1.

281. Between Rounds 1 and 2, Kellogg increased its price on a single product, Froot Loops (CX–GM 168) and General Mills, on June 7, 1965, increased its prices on 50% of its line, but also made a package size change. In accordance with his guidelines, these price changes were ignored by Dr. Scherer (Tr. 38,466–67).

Round 2

282. Kellogg, on December 9, 1965, announced that prices on 34% of its product line would increase effective January 22, 1966 (CX–K 766, 853; CX–GM 168). On January 10, 1966, General Foods announced advances on 12% of its line to be effective February 14, 1966 (CX–GF 298, 571Z–21). By December 13, 1965, four days after Kellogg's announcement, General Mills analyzed the additional

[30] The volume percentages used throughout this price round analysis refer to dollar sales volume (Tr. 27,861).

[31] It is assumed in all instances that each respondent, through its monitoring activities, was aware of each price change in the industry soon after its announcement. Evidence relating to particular instances of acquiring price change information, therefore, is not being referenced.

revenues to be generated by Kellogg's move (CX–GM 26). General Mills, on January 28, 1966, increased prices on 22% of its line effective that date, but with price protection available until February 22 (CX–GM 168, 468, 2487).

283. It is noted, however, that Dr. Scherer did not take into account two price changes by Quaker, in November and December 1965, both before Kellogg's announcement of its price increase (CX 1005). Again, the shares of respondents' product lines covered by the price changes varied considerably.

284. Dr. Scherer ignored a Quaker price move between Rounds 2 and 3—a price increase announced February 21, 1966, effective March 14, 1966 (CX 1004). [98]

Round 3

285. Kellogg, on March 4, 1966, announced that price increases affecting 48% of its line would be effective March 26 (CX–K 768; CX–GM 92, 173). Two and one-half months later, on May 17, 1966, General Foods announced increases on 36% of its line to be effective June 20, 1966 (CX–GF 300, 571Z–13; CX–GM 168). General Mills did not act until June 30, when it announced price hikes on 37% of its dollar sales volume, with price protection available until July 23 (CX–GM 168, 470, 2488).

286. Kellogg's move in Round 3 was closer in time (six weeks) to General Mills' move in Round 2 than it was to either General Foods' or General Mills' moves in Round 3 (two and one-half and four and one-half months, respectively). General Mills' move is actually closer to Kellogg's move in Round 4. Therefore, it is not clear where the round lines should be drawn and who is the leader and who is the follower. Again, General Mills' and General Foods' percentage of line covered differed from that of Kellogg.

Round 4

287. On September 2, 1966, Kellogg announced advances effective October 1, 1966, on 61% of its product line (CX–K 773, 856; CX–GM 168). General Foods announced, on September 28, 1966, that increases on 59% of its line would be effective October 24 (CX–GF 571Z–8, Z–9; CX–GM 168, 473). On October 24 or November 7, General Mills advanced 53% of its line effective that date, but allowed customers to buy at the old price until November 14 (CX–GM 168, 473). General Mills had previously analyzed Kellogg's increases and estimated that they would provide Kellogg with $5.6 million in additional annual revenues (CX–GM 175).

Round 5

288. General Foods advanced prices on 9% of its product line effective June 26, 1967 (CX–GF 304). This action was not followed by any of the other producers. Nevertheless, Dr. Scherer included it because it satisfied his basic criteria for classifying a price move as a round, *i.e.,* a price advance on more than one product at the same time (Tr. 27,825, 27,830–34). Dr. Scherer, however, ignored a price increase by General Foods on June 1, 1967, on 8% of its product line because it only involved one product (Tr. 38,467).[32] **[99]**

289. This solitary move by General Foods is totally inconsistent with a Kellogg price leadership premise.

Round 6

290. Kellogg announced on August 4, 1967, that price increases on 20% of its sales volume would be effective on August 26 (CX–K 777, 858; CX–GM 168). On August 29, General Foods announced price hikes on 20% of its volume to be effective September 25 (CX–GF 305, 353K, 571Z–2; CX–GM 168). General Mills made no price move (CX 1005).

291. Thus, we have General Mills making no price changes in two consecutive rounds.

Round 7

292. Kellogg, on October 27, 1967, announced that increases on 41% of its line would be effective on November 25 (CX–K 779, 859; CX–GM 168). General Foods acted first after Kellogg's increase by announcing on November 17 that price advances on 53% of its line would go into effect on December 18 (CX–GF 307, 571Y; CX–GM 168). General Mills announced on November 20 that increases on 67% of its line would be effective immediately, but customers could buy at the old price until December 9, 1967 (CX–GM 168, 477, 2491). General Mills had previously analyzed Kellogg's advances and calculated that this increase would provide Kellogg with an additional $3.7 million in annual revenues (CX–GM 180).

293. Here, we have General Mills making its first price move in over a year after having failed to participate in price Rounds 5 and 6.

[32] Dr. Scherer also ignored single product price moves by Kellogg, General Foods, Quaker and Nabisco (Tr. 38,467).

Round 8

294. Kellogg on December 8, 1967, announced price advances on 32% of its product line effective January 6, 1968 (CX–K 780, 860; CX–GM 168). General Mills, on January 8, 1968, announced price increases on products constituting 24% of its product line, effective immediately, but with price protection offered until January 27 (CX–GM 168, 478, 479, 2492). General Mills had previously analyzed this increase and predicted it would provide $3.5 million in additional annual revenues to Kellogg (CX–GM 181). General Foods did not participate in this price round. **[100]**

295. Kellogg's December 8, 1967, "lead" announcement was shortly after General Mills' and General Foods' price announcements in Round 7 and close to the effective dates of those price changes. Therefore, calling Kellogg's December 8, 1967, announcement a price lead is somewhat arbitrary.

Round 9

296. On April 25 and May 15, 1968, General Foods announced price increases effective, respectively, on May 13 and June 3, 1968. The May 13 increase alone covered products totalling 17% of its line (CX–GF 309, 310, 571U; CX–GM 168). Neither General Mills nor Kellogg participated in this so-called round.

297. Since General Foods' second price announcement followed the effective date of its first, this really constitutes two price leads by General Foods, neither of which was reacted to by General Mills or Kellogg.

Round 10

298. On August 2, 1968, Kellogg announced increases on 45% of its product line effective on August 3, but with price protection to its customers at the old price until August 31 (CX–K 782, 861; GX–GM 168). General Mills analyzed these price moves and calculated that they would provide Kellogg with an annual increase in margins of about $5.3 million (CX–GM 186, 252, 253). General Mills believed that the important aspects to the advance were: (1) the total dollars generated, (2) the percentage of Kellogg's line that was affected, and (3) the time intervals between price changes (CX–GM 194, 252). However, General Mills did not participate in this round. Neither did General Foods.

299. This gives us two consecutive "rounds", months apart, each consisting of a price increase by a different respondent, but where

that respondent acted alone. Round 10 is particularly significant, since it consists of Kellogg raising prices on 45% of its product line with neither General Foods nor General Mills reacting.

Round 11

300. General Foods announced on November 27, 1968, that it was initiating increases on 57% of its line effective December 30 **[101]** (CX–GF 313, 571O–P; CX–GM 168).[33] Kellogg, on December 30, 1968, announced advances on 57% of its line to be effective on February 1, 1969 (CX–K 786, 863; CX–GM 168).

301. On January 10, 1969, General Mills announced advances on products accounting for 74% of its line, with price protection offered until February 1 (CX–GM 108, 2493, 2494). General Mills' action followed an analysis of the additional revenues Kellogg and General Foods would generate by their price increases, and General Mills personnel noted that its pricing action followed Kellogg price advances in August 1968 and January 1968 and a price advance by General Foods in December 1968 (CX–GM 31, 35, 110A, 168, 187, 566I).

Round 12

302. Kellogg, on May 9, 1969, announced that prices on brands representing approximately 25% of its line would be increased effective June 14 (CX–K 787, 865). On May 29, General Mills advanced prices on a number of its own brands effective June 2, but with price protection offered until June 21 (CX–GM 490, 2495). General Mills had previously analyzed Kellogg's move and estimated what it would yield in additional margins (CX–GM 168, 188, 258). General Foods, on June 13, announced increases on 50% of its line effective June 30 (CX–GF 317, 571G, 1508; CX–GM 168).

Round 13

303. On November 11, 1969, Kellogg announced price increases effective December 13 on products constituting 60% of its product line (CX–K 789, 866; CX–GM 168). On November 17, General Mills announced increases on 77% of its product line, effective that day, but with price protection offered until December 6 (CX–GM 168, 288, 289, 496, 497, 2498). On November 12, General Mills had analyzed the increase and determined that it would generate $7.8 million in

[33] Actually, Quaker had previously announced price increases on November 18, 1968 (Tr. 38,468).

additional annual revenues for Kellogg (CX–GM 191, 355). By November 18, General Foods had also analyzed Kellogg's advance, stated its belief that "parity pricing" could best be established "by quickly matching Kellogg's advance," and on November 20 announced increases covering 44% of its line, effective December 15 (CX–GF 317, 320, 355, 418, 571E). **[102]**

304. This round is described by Dr. Scherer as the one "in which perhaps the most typical pattern existed" (Tr. 27,861). Kellogg led off. General Mills followed within six days and General Foods followed just three days later. While the pattern of respondents' action in this particular round may be the most consistent with price leadership, the round is atypical when compared with the 15 other rounds that are relied upon by complaint counsel, where we find that Kellogg is not the price leader, or there are long delays in price followership and even instances of non-participation by one or more of the respondents. Even in Round 13, we find a wide variance among respondents with respect to the percentage of their respective lines covered by the price increases—Kellogg, 60%; General Mills, 77%; and General Foods, 44%.

Round 14

305. On February 12, 1970, Kellogg announced that, effective March 21, it was increasing prices on products constituting 24% of its dollar volume (CX–K 791, 867; CX–GM 168). General Foods, on April 2, 1970, announced increases covering 20% of its line with an effective date of April 6, but with price protection offered until April 18 (CX–GF 315, 571C). While General Mills analyzed Kellogg's price increase, including additional revenues that would be generated, it took no pricing action (CX–GM 207, 287).

306. If Round 13 was considered by Dr. Scherer as perhaps the most typical instance of price leadership (Scherer, Tr. 27,861; CPF 8–101), this very next round fails to qualify by a large margin. Kellogg's price increase stood alone for about a month and one-half before General Foods acted. And General Mills, while it evaluated Kellogg's price increases, and ostensibly was also aware of General Mills' response, took no action.

Rounds 15 & 15A

307. General Mills announced an increase in price on RTE cereals representing 72% of its dollar volume, effective June 1, 1970 (CX–GM 502). On June 25, Kellogg announced increases on 67% of its line, effective July 25 (CX–K 793, 868). General Foods did not

participate in what complaint counsel term the first part of Round 15.

308. At the outset of what complaint counsel term the second part of Round 15 (CPF 8–105), General Mills initiated additional increases on several cereals effective September 28 and November 16, 1970 (CX–GM 2018). General Foods announced, on November 20, 1970, that it was increasing several of its own brands effective November 23, but with price protection offered until December 19 (CX–GF 319, 571A). An internal General Foods memorandum dated November 18, 1970, **[103]**comments, "The recommended increases will re-establish profit margins that have decreased versus the previous four year average and to meet recent competitive price changes. Competitive price increases have recently been taken by Kellogg—7/70 and General Mills—6/70" (CX–GF 434). Kellogg did not participate in the second part of Round 15.

309. General Foods' November 20, 1970, price increase announcement was effective December 19, 1970, over six and one-half months after the June 1 effective date of General Mills' price increase and almost five months after the effective date of Kellogg's last prior price increase. This falls far short of meeting the expectation of timely responses to a price leadership situation.

Round 16

310. Kellogg, on or before January 18, 1971, announced that it intended to raise prices effective February 6 on a number of products (CX–K 7073; CX–GF 449; CX–GM 205). General Mills and General Foods both announced price increases on January 29, effective February 1, with price protection offered until February 20 (CX–GF 1525, 1699; CX–GM 449, 2018, 2019). Complaint counsel have offered no evidence as to percent of line covered or dollars generated by the price moves in this round. Dr. Scherer's theory that respondents coordinated price increases by covering equal percentages of products cannot be tested.

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311. In addition to the failure of complaint counsel's price rounds presentation to contain the necessary product and pricing information upon which to evaluate an alleged price leadership-price followership situation, the rounds, to the extent they do furnish information, are inconsistent with price leadership-price followership.

312. Kellogg is alleged to be the price leader. Yet, it was first in

only 12 of the 16 price rounds (12 of 17 if Round 15 is considered as two separate rounds, as well it may be). Of the 12 rounds in which Kellogg was first, General Mills followed in only nine instances, and General Foods in only 10 instances. General Mills and General Foods together followed in only eight of the 12 rounds in which Kellogg changed its prices first. General Foods led three times, and on two of those occasions neither Kellogg nor General Mills followed. General Mills led once (twice if Round 15 is considered to be two rounds). Kellogg alone followed in Round 15. General Foods alone followed in Round 15A.

313. Without repeating the details listed in the round by round analysis made above, it is clear that the long delays in price **[104]** followership and the instances where price changes were not followed at all render complaint counsel's price round presentation inconsistent with a price leadership-price followership premise. It is also clear that the wide variations in dollar share of line affected by the separate price changes of the individual respondents is inconsistent with Dr. Scherer's theory that overall price uniformity was achieved by coordinating dollar share of line covered by price changes.[34]

314. On December 20, 1977, following four days of direct examination, Dr. Scherer on cross-examination, for the first time, presented a new explanation of how respondents were coordinating prices (a theory of comparable dollars generated per share of the market) (Tr. 28,519). This new theory was one which had occurred to Dr Scherer just several days before (Tr. 28,576, 28,619, 28,620). What Dr. Scherer did was to divide the additional dollars generated by each firm's price increase by that firm's market share (Tr. 28,620).

315. As one basis for his theory, and in order to ascertain dollars generated, Dr. Scherer relied upon CX–GM 168. CX–GM 168, though found in the files of General Mills, was prepared by an unidentified employee of General Mills and there is no indication of the purpose for which it was used by that company. The accuracy of the data contained in CX–GM 168 is suspect, subject to verification by corroborating evidence (to which complaint counsel have not called my attention), and the document is binding on General Foods and Kellogg only to the extent of evidencing that such a document was prepared at General Mills (*See* Tr. 10,614–16).

316. In preparing a comparison of dollars generated by price moves, Dr. Scherer did so on an annual basis for the years 1963–1968

[34] General Mills' practice of estimating additional profits to be generated by Kellogg's price changes is not inconsistent with a general business interest in evaluating activities of competitors. It does not prove Dr. Scherer's theory, particularly in light of respondents' disparate actions. Further, there is no evidence of such analyses being made by the other respondents.

and reflected the results of all price moves, including those excluded in the preparation of his price round analysis (Tr. 28,519–21, 28,581–82). Dr. Scherer conceded that if he had attempted such a correlation on the basis of his price rounds, his coefficients of correlation would have been much less (Tr. 28,591). For the 1963–1968 period considered by Dr. Scherer, General Mills increased its prices at a rate 30% higher than Kellogg; and in every year other than 1963 and 1966, General Mills' price increases generated at least 30% more dollars than did Kellog's price increases (Tr. 28,595–608). **[105]**

317. Dr. Scherer's theory of comparable dollars generated, therefore, bears no relationship to price leadership in lieu of overt collusion. It takes no account of prices on particular brands, although it is clear that competition is on a brand basis. It totally ignores the price rounds, which serve no purpose under this theory. His theory abandons parallelism by price move. Dr. Scherer has simply advanced the assertion that, over the years, prices for the several respondents have increased in a similar fashion (although, in fact, General Mills' price have increased at a 30% greater rate).

Price leadership in lieu of overt collusion contemplates a simple action and reaction. It would cover a situation where A would raise its price on a particular item by 5¢ and B would follow and raise its price by about the same amount. The theory, however, would not apply to the complicated situation envisioned by Dr. Scherer where each respondent would calculate the added revenues that would result from price raises on a number of products by another respondent and then, selecting its own and frequently different type products, work out price increases that would accomplish a similar overall profit increase for it—all in relationship to share of market entitlements. This simply is not contemplated by the economic theories advanced by complaint counsel. It is difficult to comprehend how such a complex arrangement could be reached short of working out an express agreement.

318. As Dr. Telser testified, the figures relied upon by Dr. Scherer merely reflect a crude form of RTE cereal price index (Tr. 31,670–71). One would expect a degree of correlation over time for products that are closely related in terms of condition of supply and demand such as RTE cereals (Tr. 31,674). Dr. Scherer's supposition that this was the result of collusion or price leadership in lieu of overt collusion remains a supposition. It is not established by the record in this case.

319. It is concluded, therefore, that complaint counsel have failed to prove a conspiracy on the part of respondents relative to the establishment, maintenance or change of prices for RTE cereals.

Neither have they proved that respondents engaged in price leadership-price followership in lieu of overt collusion.

3. *Other Forms of Price Competition*

Complaint counsel assert (CPF 8–111):

> In addition to avoiding direct competition on the list prices of RTE cereals, respondents also avoided virtually all other forms of price competition that might have destabilized the market by spiraling into unrestrained competition. Respondents refrained from offering trade deals [106](discounts) to customers, from producing private label cereals, and from using "cents-off" labels that would provide consumers with the benefits of at least some price competition. Respondents' avoidance of each of these forms of competitive behavior demonstrates their success at restraining all significant forms of competitive rivalry and maintaining high prices and monopoly level profits.

However, as I have already found, complaint counsel have failed to establish that respondents, either by agreement or by means of a price leadership-price followership regimen, fixed or controlled list prices. Any evidence tending to show parallel action with respect to indirect pricing activities such as trade deals, lower priced private label cereals and cents-off labels, therefore, is of no consequence in establishing the existence of support mechanisms to a price fixing situation.

(a) Competition Through Price Promotions

(i) Trade Deals

320. Trade deals are payments by manufacturers to retailers, usually in the form of discounts off the wholesale case price of the manufacturers' products (Tr. 9267, 27,956, 33405–06; CX–GM 16A). Trade deals are offered to retailers either in exchange for some performance promoting the manufacturer's products or they may have no performance requirement. The promotional services required of retailers may include setting up special display shelves, featuring a cereal brand at a reduced price, placing coupons redeemable at the retailer's store in the retailer's weekly advertisements, or stocking a new product or package size (Tr. 33,405–06).

321. Both before and immediately following World War II, trade deals were prevalent throughout the RTE cereal industry (CX–GF 18 O, 4039Z–108). During the mid to late 1950's, the use of trade deals declined considerably (CX–NCFM 500 at 162; CX–GF 507I). Thereafter, for some ten years, the trade deals used by the RTE cereal producers were primarily introductory allowances. Such allowances

are used when new products are introduced to compensate retailers for additional expenses incurred in adding the new products to the retailers' shelves for warehousing and adding to accounting and computer systems (Tr. 7990, 11,341, 17,306–07, 27,957–58).

322. General Mills felt that trade deal activation by any of the major producers would lead to retaliatory trade deals or some other price reaction by the others (CX–GM 16, 17, 135B, C, 140, 142A). It [107]believed that if trade deals were activated, "major competitors would retaliate immediately to protect their present share of [the] market" (CX–GM 135B, C). It also believed that neither Kellogg nor General Foods was "anxious to try an activation [trade deal] war" (CX–GM 17D). It reasoned that, in order to pay for a trade deal program, Kellogg and General Foods would have to "(a) cut advertising, (b) cut profit, [or] (c) raise prices." General Mills could not "see either competitor deciding to cut profits." If Kellogg and General Foods "were to increase their prices—to lay out additional trade money—we, in turn, following competition, could do the same and retain, if not improve, our profit margins" (CX–GM 17D).

323. General Mills' advertising agency, which had been closely associated with it for years (CX 443), stated that the cereal industry "has resisted pressures to enter into the allowance [trade deal] battles which most other package goods categories wage continuously. The reason has been that once this type of activation is made to work to one company's overall advantage, . . . competition must retaliate and it soon becomes more of a defensive than offensive marketing device" (CX–GM 16B).

324. General Foods also was aware that any initial sales benefit that it could gain from the use of trade deals might be wiped out by responsive actions by others (CX–GF 76C). It believed that "The highly price competitive nature of the cereal market in the early 1950's (price off, trade deals, pack-ins) . . . suggests that price maneuvers may be at most a short term advantage" (CX–GF 76C, 4039Z–108). Thus, we find that "As a general rule, Post cereals . . . [would] not utilize trade deals" except on new products or new sizes or major product changes (CX–GF 601K).

325. When asked by a grocery store chain about straight case allowances vis-a-vis allowances with performance requirements, Kellogg's General Sales Manager told the chain that Kellogg did not want to get store premium types of trade deals started again; that it did "not want to give case allowances just to establish everyday low prices" (CX–K 7144A).

326. The foregoing recitation of evidence relied upon by complaint counsel reflects an awareness by each individual respondent

of what competitive practices, including trade deals, are taking place in the industry. It additionally evidences each respondent's individual desire not to precipitate a price war by giving trade allowances other than those offered in connection with the introduction of new products. List prices having been arrived at after considering costs, competitive factors and profit objectives, it is reasonable that respondents would not want to sell at lower prices by reason of trade deals which could establish a permanent discount at which retailers could stock up on all their needs. It is to be anticipated, therefore, that respondents would be selective in offering trade deals. **[108]**

327. Respondents evaluated each other's potential to resume large scale trade deal activities and, while they did not anticipate such a resumption, they each stood ready to respond by competing in like fashion should another start.

328. The foregoing does not reflect an agreement with respect to competition by offering trade allowances. No respondent was waiting for a signal from any other respondent to resume large scale trade allowance activities, nor is there any evidence that an agreement or action by a leader precipitated the decline of trade deals in the 1950's.

329. While the record shows an evolvement over time from heavy use of trade allowances prior to the middle or late 1950's to relatively little use until the end of the 1960's, when the practice was resumed, there is no evidence of an abrupt shift or of other timing consistent with agreement of leadership.

330. Kellogg has employed trade deals on some of its most popular established brands since 1966. Kellogg employed trade deals with Product 19 each year from 1966 to 1970. It gave trade allowances on both Corn Flakes and Shredded Wheat in 1968 and 1969, on Special K in 1969 and on Raisin Bran in 1970 (CX–K 1072).

331. General Mills employed trade deals with most of its established cereal brands in 1969 and 1970 (KX 203C).

332. By 1971, each respondent offered trade deals on the majority of its brands. General Mills enlarged its trade deal activity in 1969 to carry trade deals on 11 of its 15 brands (CX 409C), stepped up its trade deal activity in 1970, and then reached an even higher level in 1971. Kellogg waited until 1971, at which time it extended its trade deal usage to 18 brands of its 20 brand product line (CX 409B). General Foods also waited until 1971 to act. During that year, it used trade deals with nine of its 14 brands.

TRADE DEAL USE, 1966–1971

	Kellogg		General Mills		General Foods	
	No. of Deals	No. of Brands Affected	No. of Deals	No. of Brands Affected	No. of Deals	No. of Brands Affected
1966	3	2	(not available)		9	2
1967	6	2	3	3	10	2
1968	5	3	5	4	1	1
1969	5	4	15	11	3	3
1970	4	3	29	10	3	3
1971	58	18	38	14	16	9

(KX 201–04) [109]

333. Thus we see that in 1969, General Mills (not Kellogg, the alleged price leader) was the first to reinstitute the wide use of trade deals, and that Kellogg and General Foods waited until 1971 before they engaged in trade deals as a general practice. The sequence and timing of respondents' resumption of trade deals negates complaint counsel's contention that respondents coordinated their utilization of trade deals so as not to upset the equilibrium of their alleged list price arrangements; and there is no evidence demonstrating the sequence or timing of respondents' earlier abandonment of trade deals sometime in the 1950's.

334. Complaint counsel rely upon the fact that, unlike the situation for RTE cereals, trade deals were used frequently to promote other grocery products from 1960 through 1972 (Tr. 8556, 8903, 9267–69, 18,001–02; CX–GM 16B, 142A). RTE cereal sales, however, are not as responsive as other food products to promotional stimuli such as trade deals. Since consumer RTE cereral purchases do not change much seasonally, unlike products such as Kool-Aid, there is less need to use trade deals to provide rapid inventory build-up to cover surges in consumer demand (Tr. 36,848). In General Mills' opinion, the additional volume of RTE cereals moving to retailers under trade deals caused shelf space and inventory problems for retailers, inasmuch as RTE cereals were considered "[t]oo bulky for display purposes," and inventory overflow caused "floor and back room space problems" (CX–GM 140B).

335. General Foods has established that its utilization of trade deals over the years was responsive to, and consistent with, marketing and business factors and problems which it had to face.

336. Trade deals on RTE cereals were perceived by General Foods as effective primarily in prompting grocers to promote particular products, but not in securing retail price decreases (Tr. 36,847–49). Advertising has been perceived by General Foods as the

most effective and efficient marketing tool for making consumers aware, and inducing their trial, of General Foods cereal products (CX–GF 3000Z–76–77).

337. General Foods' fluctuating use of trade deals must be viewed against the background of: (a) the dramatic growth of television in the middle 1950's just as its cereals were losing market share, and General Foods' shift of marketing emphasis from promoting individual cereals to advertising its full line of products, (b) General Foods' efforts to introduce new products in the early 1960's, which directed marketing resources away from existing products and led to a deemphasis of the line approach, and (c) the sudden leveling off of RTE cereal sales in the late 1960's, which led General Foods to increase its use of promotions. **[110]**

338. Prior to FY 1958, which began in April 1957, the Post Division engaged in "individual brand promotion where each Post product was sold on its own merits in competition with both other Post brands and other company brands" (CX–GF 16A). However, the share of total RTE cereal sales represented by Post cereals declined from over 27% in early 1952 to less than 23% in late 1956 (GFX 203B).

339. The management consulting firm of McKinsey and Company ("McKinsey") was retained to study the problems of the Post Cereals Division and to recommed a remedial program. In its July 1956 report to General Foods, McKinsey recommended that "the Division should . . . emphasize the promotion of the Post 'line'" (GFX 1235Z–4).

340. Shortly thereafter, in September 1956, a new "Marketing Philosophy" (GFX 1288) was adopted by the Division calling for "advertising and selling a *line* of cereals as opposed to individual brand marketing" (emphasis in original) (CX–GF 16A).

341. As part of this change, the Division's management decided to increase consumer-directed advertising. To implement this, the Division greatly increased its use of what was then a new marketing tool—television (Tr. 36,355–61).

342. During FYs 1952–1955 (April 1951–March 1955), television advertising accounted for approximately 25% of General Foods' cererals' consumer-directed marketing expense (GFX 203J). This grew to nearly 50% in FY 1956, over 60% in FYs 1957–1959 and over 80% in FY 1960 (GFX 203J; *see also,* CX–GF 4T–U).

343. Thus, after the FY 1956 introduction of the line approach, the emphasis was shifted away from those marketing tactics that are most effective with respect to individual products—*e.g.,* trade-directed activities—into line-oriented advertising, especially television.

344. By 1960, there was significant improvement in consumer perception of General Foods' cereals (CX–GF 1300G). Therefore, in planning for FY 1961, the Post Division's management decided that "[a]fter three years of intensive line promotion," it was time to "capitalize fully on the high consumer awareness of the Post line theme" by developing "more individual brand sell in [RTE cereal] product advertising" (CX–GF 324K).

345. In FY 1962, the return to individual product promotion accelerated, but with advertising continuing to play a more important role than it had in the early 1950's:

> [W]e plan to continue the strong individualistic approach in each of our product commercials. This approach identifies the product as one of the [111]family of Post Cereals but proceeds to sell the product on its own individual merits (CX–GF 6B).

346. In February 1965, General Foods was of the opinion that money was better spent on consumer advertising than on trade deals:

> Post believes that consumer advertising is a more effective and efficient *long term* benefit to cereal success—so trade deals will not be employed. The only exception is the introduction of a new product (and in some instances, a new *size*) where a trade deal may be employed as an aid in establishing broad-scale distribution (emphasis in original) (CX–GF 485Z–7).

347. The advertising emphasis on individual products continued through FY 1966 (CX–GF 485L, 1300E–G).

348. In FY 1962, the managers of the Post Division had decided to undertake "a substantial new product program" based upon "a number of innovative products and concepts on hand" (CX–GF 4039Z–17). This program was undertaken (GFX 1370H–I).

349. The Division's marketing managers believed "that during periods of new product introduction, advertising and promotional support for established brands could be reduced without impairing the vitality of their franchises" (CX–GF 4039Z–18); "that the halo effect of the new product would compensate for the lack of [advertising and promotion] support on the established brands" (CX–GF 4039Z–19). Accordingly, from FY 1962 through FY 1966, the Division's managers followed a marketing strategy of "holding volume on established brands by according them the minimal advertising and promotional support consistent with that objective" (CX–GF 4039Z–17).

350. From 1950 through 1965, there had been continuous and substantial growth in sales of RTE cereals. Then, pound sales of RTE cereals grew by only .4% in 1966 and declined by 2.1% in 1967 (CX 101E).

351. By late 1966, both established Post cereals and new products were considerably below their planned volume and profit goals (CX–GF 4039B). In November 1966, a special Post Cereal Task Force was organized "to complete an in-depth examination of all areas appropriate to the cereal business and recommend a three year operating strategy for the cereal business" (CX–GF 4039B).

352. In its 1967 report (CX–GF 4039), the task force recommended that "each advertising message [be devoted] exclusively [112]to the individual brand rather than to line sale" (CX–GF 4039P). It recognized that consumer promotion was "an effective means of generating short-term incremental sales in the cereal business" (CX–GF 4039Z–111). It, therefore, recommended that promotional expenditures be raised "above the levels of recent years" (CX–GF 4039Z–114).

353. By the following year, the Division was fully committed to using promotions to "[s]ecure short-term volume increases" (CX–GF 602G), and in the reallocation of marketing resources from advertising into promotions (CX–GF 3000Z–23i).

354. Trade deals have consistently played a relatively small role in the marketing of General Foods' cereals:

TRADE DEALS ON GENERAL FOODS' CEREALS FY 1952–1961
(in thousands of dollars)

Fiscal Year	Total Marketing Expense	Trade Deals	Trade Deals as a Percentage of Total Marketing Expense
1952	14,385	277	1.92%
1953	16,431	200	1.21%
1954	15,958	310	1.94%
1955	15,706	526	3.34%
1956	16,626	490	2.94%
1957	16,562	332	2.00%
1958	16,850	59	0.35%
1959	21,630	221	1.02%
1960	17,776	223	1.25%
1961	16,977	50	0.29%

355. While there was a clear decline in General Foods' use of trade deals beginning in FY 1958 from 2% to .35%, this is explained by the change in the Post Division's marketing strategy from an emphasis on individual products to an overall line approach, the belief that promotional efforts on new products would have a halo effect on established products, and the switch to television as a preferred method of promotion. The subsequent switch back to trade

deals reflects the poor performance of both new and established General Foods products and the decision that it was necessary to use promotions, such as trade deals, to secure short-term increases in sales volume.

356. Complaint counsel do not contend that, when utilized, respondents did not attempt to gain competitive advantages by their [113]trade deals. Thus, CX–GM 17, a December 1970 General Mills memorandum, recommended a "Plan B" trade deal, providing for extra retailer displays, features and price reductions on Wheaties, because it was felt that General Mills' sales force could "better handle activation than theirs [Kellogg's and General Foods']" (CX–GM 17E), and that General Mills could profitably gain consumer sales by using the trade deal (CX–GM 17).

357. Respondents made extensive use of trade deals throughout the complaint period in connection with the introduction of new products (Tr. 7990–91, 11,341–42, 12,306, 13,094, 17,306–07, 27,956–58, 36,934). Introductory trade deals were considered by respondents to be particularly useful to secure retailer acceptance of new products and thus "as an aid in establishing broadscale distribution" for new products (CX–GF 485Z–7). It is immaterial whether an introductory trade discount on a new product is considered to constitute a lowering of price from an established list price or as establishing an initial price below list. In either event, the product is being offered at a relatively low competitive price; and that is price competition between the new product and products already on the market.

(ii) Cents-Off Deals

358. Complaint counsel (CPF 8–111, 8–164) assert that respondents avoided the use of cents-off labels as part of their avoidance of all forms of price competition practices that might disrupt their established pricing structure.

359. A "cents-off label" is an announcement printed on a package indicating that the product contained in that package will be sold for a specified amount less than the listed retail price (Tr. 17,246).

360. Respondents used "cents-off" deals in the early 1950's, but not thereafter (Tr. 17,246, 30,111–12; CX–K 1073C, 7144; CX–GF 485Z–6, 4039Z–108). The record, however, does not indicate the extent to which this type of promotion had been engaged in, nor is there any evidence showing the sequence or timing of the cessation of this practice by respondents. As with the case of trade deals, there

is no evidence of an agreement among respondents not to engage in this practice.

361. Kellogg believed that if "one company starts it [cents-off deals], the others follow suit" (CX–K 139C). Although General Mills believed that "cents-off" promotions were powerful enough to "get immediate positive results" if used by competitors, it did not use such methods (CX–GM 135B, C; Tr. 17,246). General Foods believed that "price maneuvers" such as cents-off labels "may be at most a short term advantage" (CX–GF 4039Z–108); that respondents had avoided this type of rivalry because of the "bitter taste" of previous [114]competition and the danger that such actions would result in a "dilution of impact/inefficient investment of marketing funds" (CX–GF 76C). It stated that it would, "not utilize off-label packs unless competitive activity forces the issue" (CX–GF 601L). A General Foods' marketing plan summarizes its attitude toward cents-off labels:

> The nature of the Cereal business (in terms of multiplicity of brands and categories with little, if any, brand loyalty) is such that judgment indicates it would be an ineffective and inefficient expenditure of a brand's "lean" marketing funds to engage in a price-cutting battle via cents-off consumer promotion. Money so employed would be a risky drain on funds available to advertise brands' basic consumer benefits—which Post believes is the key to long-term cereal business success. Cents-off promotions will never be used (CX–GF 485Z–6).

362. The facts developed with respect to cents-off deals reflect a situation similar to that involving trade deals—an awareness by respondents of competitive practices and reasons why this practice has not been utilized by the individual respondents, apart from an agreement or an attempt to fix prices by price leadership. More particularly, with respect to General Foods, they reflect an implementation of its line marketing strategy at a time its products were not being promoted on an individual basis.

(iii) In-Pack Premiums[35]

363. In-pack premiums are small items, such as toys or games, that may be placed in boxes of RTE cereals to promote sales to consumers (CX–K 1073E; CX–GM 2115). Complaint counsel charge (CPF 8–171, 8–175) that respondents reached an express agreement to limit the use of in-pack premiums.

364. There is no direct evidence of such an agreement. As was the situation with respect to price fixing, top executives of each [115]

[35] This means of competition is being considered as a type of price promotion, since the offering of a premium along with the cereal at no additional cost acts as a price reduction to the extent of the value of the premium.

respondent have testified to the effect that decisions regarding in-pack premiums were made independently; that there was no express or tacit agreement among respondents regarding their use (Tr. 29,726, 29,944, 32,768, 35,462, 35,815, 36,361–62). Again, the testimony of Kellogg and General Mills officials falls within that which I am required to accept at face value. And if Kellogg and General Mills had no such agreements with General Foods, it follows that General Foods had no such agreements with Kellogg or General Mills. Unless overcome by more persuasive evidence, I am required to accept such testimony as accurately describing the situation.

Complaint counsel assert (CPR 8–175) that the alleged explicit agreement is demonstrated by (1) the importance respondents placed on the marketing effectiveness of in-packs; (2) the chronology of respondents' decisions to decrease their usage of in-packs; and (3) the expressed and implied recognition by respondents with respect to an understanding among themselves to limit in-packs.

365. Before 1957, respondents inserted in-pack premiums in many of their brands at the same time (Tr. 11,228, 13,023, 13,025; CX 1006; CX–GF 371). In 1956, Kellogg carried 36 in-packs in nine brands representing a range of approximately 12% to 23% of Kellogg pound volume over the year. General Mills carried 11 in-packs in five brands for a 6% to 12% volume share, and General Foods used in-packs in 13% to 23% of its pound volume. From April 1955[36] until January 1957, Kellogg used in-packs in cereals that accounted for 9.5% to 19.4% of its pound sales volume; General Foods used them in 9.5% to 22.4% of its sales volume; and General Mills used them in 6.2% to 15.1% of its sales volume (CX 1006; CX–GM 2115; CX–GF 371, 372).

366. Ralston, not one of the respondents, was the first major firm to discontinue putting premiums in packages. It did so by February 1956 (Tr. 28,753–55; CX–NCFM 500, at p. 177). General Mills started to decrease its use of in-pack premiums in October/November of 1956. This was some eight months later. Neither Kellogg nor General Foods decreased its use of in-pack premiums at that time. On the contrary, Kellogg increased its use of in-packs during February/March and April/May of 1957; and General Foods continued to increase its use of in-packs from February/March until June/July 1957. Just after reaching their peak of in-packs usage, Kellogg and General Mills began a precipitous decline in mid-1957. By August 1957 (General Mills), February 1958 (Kellogg) and March

[36] The record does not reflect detailed data on the use of in-packs prior to 1955.

1958 (General Foods), respondents were inserting in-packs in less than one half of one percent of their product volume (CX 1006). **[116]**

367. Thus, the chronology of respondent's change in their usage of in-packs does not support complaint counsel's assertions as to agreement. With regard to the importance respondents placed on the marketing effectiveness of in-packs, complaint counsel have failed to demonstrate that respondents acted against their best individual interests when they curtailed this promotional device.[37] To the contrary, the record tends to demonstrate significant business and marketing circumstances to which respondent's actions were reasonable individual responses.

368. In-pack premiums are used in the RTE cereal industry to provide short-term sales increases for the specific brands so promoted. In-packs, generally, are not credited with beneficial sales results extending beyond their term of use or beyond the particular brand with which the premium is employed (Tr. 12,435–36, 36,351–52; CX–GF 4, 485Z–4; CX–K 487, 546K, 650A). Television advertising, on the other hand, is regarded as uniquely effective in the RTE cereal industry in establishing long-term sales expansion (Tr. 29,930, 36,352, 36,361; CX–GF 485Z–7).

369. Television advertising appeared as a significant factor in the growing RTE cereal market in the early 1950's, and its employment rapidly expanded immediately prior to the decline of in-packs. Kellogg spent $706,000 in 1950 on television advertising, representing 8.3% of Kellogg's advertising budget. By 1957, Kellogg's television advertising had expanded to $13,537,000, which was 78.3% of total advertising expenditures. For the same period, General Mills' television advertising increased from $548,000 to $6,533,000. This was an increase from 10% to 83% of General Mills' total advertising expenditures. General Foods' television advertising jumped in similar fashion from $773,000 (12% of its total advertising expenditures) in 1951 to $5,863,000 (85.4% of total advertising expenditures) in 1957. RTE cereal television advertising by respondents continued to expand through the 1950's and early 1960's (GFX 1319).

370. Thus, it is reasonable to believe that each respondent independently reacted to the advent of television as an effective **[117]**advertising medium by shifting from promotional expenditures

[37] Complaint counsel would support their assertion that respondents placed great importance on the marketing effectiveness of in-packs by a number of respondent documents extolling the benefits of in-packs (*see, e.g.*, CX–K 37A, 47D, 650A, 651; CX–GM 38A; CX–GF 76B). These documents, however, were prepared in the last half of 1960 and in early 1970, when market conditions had changed and respondents were about to use, or were using, in-pack premiums. They do not indicate that respondents curtailed their use of in-pack premiums in the face of competitive reason why they should have been continued.

such as in-pack premiums to television advertising. Kellogg decided to make the shift (Tr. 11,235–36). So did General Foods (Tr. 14,181).

371. General Foods decided to replace in-pack promotions with television advertising as part of its strategy, initiated in 1957, to market Post cereals collectively as one line of cereals rather than as individual brands (Tr. 36,352, 36,356–62; CX–GF 5A, 18T; GFX 406A). The new line strategy emphasized television advertising as a means of increasing sales of the Post line of ready-to-eat cereals and relegated consumer promotions to a supplemental role (CX–GF 5B). Post sought to replace the prior marketing approach, which emphasized individual brand promotions such as in-packs, with heavy investment in advertising in order to create long-term expansion of Post line sales (Tr. 36,351–52, 36,360–61). The change in marketing philosophy resulted in a shift of marketing funds from premium promotions to advertising (CX–GF 16A, 406B). In 1952, General Foods' television spending on RTE cereals amounted to 30% of total marketing expenditures. In 1957, it had risen to over 60% (CX–GF 507I).

372. General Foods, in August 1967, referred to the previous in-pack rivalry as "fierce and unprofitable competition" (CX–GF 76A) and stated:

> We do not believe that any manufacturer will benefit—on a long term basis—by reverting to the premium wars of the 1950's (CX–GF 75).

General Foods ". . . recognized . . . that too intensive utilization[of in-packs] is certain to bring strong competitive retaliation. This would not serve the best long-term interests of Post, and could even be deleterious in the short-term" (CX–GF 4039Z–114). General Foods believed that the respondents avoided this method of competition because of the "bitter taste" of previous competition in this area. However, it was prepared to reinstitute the use of in-packs if Kellogg or General Mills started first (CX–GF 76A, C).

373. Kellogg had an "arsenal of package inserts ready to go" if another respondent resumed the practice (CX–K 546K). General Mills believed that if Kellogg got "the in-pack fever," General Mills would "probably have to follow" (CX–GM 38A).

374. The common evaluation by the several respondents as to the undesirability of resuming extended in-pack competition, and their stated readiness to respond if another competitor reinstituted the practice, does not evidence the existence of a conspiracy some ten years before, or a continuation thereof.

375. This brings us finally to several documents produced from the files of General Foods which refer to an industry guideline or

[118]rule. The first is a memorandum dated August 3, 1967, from a Mr. R. S. Braddock to a Mr. R. P. Brubaker (CX–GF 76). Mr. Braddock was an assistant or associate product manager under Mr. Brubaker, who was a product manager for a number of items. Mr. Brubaker was subordinate to Mr. Cobb, who was in charge of marketing (Tr. 14,593–94). In that memorandum of Mr. Braddock, we find the following:

Subject *Defensive Premium Plan*

This memo will

. . . analyze the likeihood of competition breaking the pack-in premium guideline;

* * * * * * *

Summary

If competition packs premiums in several presweet brands (thus breaking the industry "guideline") and we take no action until they arrive at retail, we risk loss of at least $1,100M in PBT.

* * * * * * *

Discussion - Rationale for Plan

To date, the three major manufacturers in the cereal business have been respecting an "unwritten rule," stemming from fierce and unprofitable competition in the early and middle '50s, that they have retail exposure with only one pack-in premium in one brand at a given time . . . (CX–GF 76A).

* * * * * * *

In summary, it is likely that Kellogg and General Mills *will* read the favorable Alpha-Bits experience and *will* react by putting greater emphasis in pack-ins but that they will do so within the existing guidelines—one premium in one [119]brand at a time (emphasis in original) (CX–GF 76C).

376. On August 11, 1967, Mr. Brubaker apparently forwarded Mr. Braddock's Defensive Premium Plan to Mr. Cobb. In Mr. Brubaker's forwarding memorandum to Mr. Cobb (CX–GF 75), he stated:

Subject *Defensive In-Pack Premium Plan*

In view of the persistent rumors that Kellogg is planning to pack premiums in several cereals, it is advisable for us to have a defensive plan prepared. Such a recommended plan is attached (emphasis supplied).

This recommended plan would enable us to strike back with four brands at retail containing premiums in a reasonably short period of time—for the modest investment of $10,000.

We recommend this investment in order to be prepared to launch such a program; however, we feel very strongly that if we learn that another manufacturer is packing premiums in multiple brands, our *first step* should be to do everything possible to ascertain the long term intent of the manufacturer in this area . . . (emphasis in original).

377. Thus, we find Mr. Brubaker not only forwarding Mr. Braddock's plan, but personally expressing concern if another manufacturer (possibly Kellogg) should pack premiums "in multiple brands." On the other hand, the reference to "rumors that Kellogg is planning to pack premiums in several cereals" indicates that the parties were not operating under explicit agreements, as complaint counsel contend.

378. In a May 1968, memorandum to Mr. Cobb from a Mr. P. A. Schweitzer, another assistant or associate product manager (Tr. 14,594–95), Mr. Schweitzer analyzed possible competitive reaction to a planned in-pack in Alpha-Bits. In that memorandum, we find: **[120]**

Being rational they will realize that if we were seriously going to pursue the multiple in-pack premium route, we would use a much stronger premium and it would be supported much more heavily.

In view of the above points, breaking a "magic guideline" with this paper pack-in will not force competition into reacting (CX–GF 26B).

So again, we find comment concerning a guideline which refers to the multiple use of in-packs.

379. If, in fact, there was a conspiracy to limit in-packs to one product at a time, the statements of Messrs. Brubaker, Braddock, and Schweitzer would have been made during the course of and in furtherance of that conspiracy. Without these memoranda, however, there is no *prima facie* evidence establishing such a conspiracy. The documents, therefore, may not be considered against General Mills or Kellogg for purposes of establishing a conspiracy or agreement as to in-packs (*supra,* p. 19).

380. Even if the documents could be used against all parties, standing alone it is unclear just what they would evidence. The reference to a gentlemen's agreement or guideline, coupled with the specific limitation of only one in-pack promotion at a time, does indicate the existence of an actual agreement. However, the period of time encompassed by that agreement would remain unsettled. The documents prepared in August 1967 and May 1968 purport to recite the situation then existing. They would not establish that the parties mutually abandoned the use of in-packs some ten years earlier, as complaint counsel contend. The evidence showing independence of action at that prior time (*supra,* Findings 365–67) is much too strong

to be overcome by these documents. The documents, therefore, at most are consistent with a later understanding, around 1967 and 1968, not to resume in-packs on a multiple scale. And the reference to rumors concerning Kellogg's intention to utilize multiple in-packs reflects General Foods' belief that Kellogg did not consider itself bound by any such understanding.

381. General Mills' analysis, in December 1967, was that the use of in-packs would favor Kellogg's medium sized brands; that without in-packs, General Mills' established brands had outperformed those of other companies, "even during the year in which Post went back to using them on several brands." The memorandum concluded, "Let's hope Kellogg does not get the in-pack fever because if they do, we'll probably have to follow and suffer" (CX–GM 38). This indicates that General Mills, in December 1967, was not using in-packs because of its own business judgment. It also evidences that General Foods, during one unidentified year, had in-packs on several brands. This would be inconsistent with an alleged agreement not to have multiple in-packs. **[121]**

382. Going one step further and assuming, *arguendo,* that the parties had a gentlemen's agreement in 1967 and 1968 not to use multiple in-packs, this would constitute the only promotional arrangement shown to exist among respondents. In-packs are a relatively expensive promotional device (Tr. 11,232; CX–GM 233; CX–GF 4013S; CX–K 546K) and are unique in that they put respondents "into the toy and gimmick business rather than the cereal business" (GFX 406A). A gentlemen's agreement limited to curtail this practice would be insufficient to establish an overall agreement not to compete pricewise or in any other fashion.

383. In any event, respondents resumed more extensive use of in-packs beginning in 1968, and increased utilization through 1972 (Tr. 21,906, 21,937; GMX 531; CX–GM 2115; CX–K 1073). This was in response to the lull in overall market growth and the respondents' ostensibly independent decisions to promote individual brands by short-term means such as in-packs (CX 101E, CX–GF 3000I, X, Z–100; GMX 241, 531A–F, 552A, 555A, 556A; GFX 1319). General Foods' resumption of in-packs was part of the abandonment of its full line advertising policy in favor of a brand promotional strategy (CX–GF 3000Z–11, Z–12, Z–20; 4039 O, Z–114, Z–115).

(iv) Coupons

384. Respondents' couponing activities negate complaint counsel's contentions that respondents avoided price related promotions.

Dr. Scherer, one of complaint counsel's economic experts, testified that respondents' couponing "remained at a fairly significant level during the 1960s" and was "widespread" (Tr. 27,967–68). Since 1965, when data on coupons for all respondents is available, each respondent used coupons on both established and new products (GMX 475–96; KX 78, 201C thru 204C; GFX 1336–44).

385. Kellogg distributes coupons inside cereal packages, in newspapers or through the mail, offering discounts worth usually five to 15 cents redeemable at retail stores. Retailers are reimbursed by Kellogg for the face value of the coupon, plus handling costs of two cents per coupon (Tr. 29,924–25).

386. From 1966 to 1972, Kellogg used coupons on products representing 75 to 80% of its line (KX 79A–H, 80; GFX 1319). Kellogg's yearly marketing plans show its strong reliance on coupons for promoting sales (*e.g.,* CX–K 7178K, 7179G, 7180H, 7193J, 7194M, 7195M, 7196K, 7198F, G, 7201G, I, 7207H, M).

387. General Mills used two types of coupons to promote its products. "Manufacturer coupons" are coupons which General Mills distributes to the consumer by direct mail, by distribution at shopping areas, through magazines and newspaper advertisements, or by **[122]**packing them in boxes of cereals or other General Mills products. The consumer redeems these coupons at the store when purchasing cereal. "Retailer coupons", denominated Plan F and Plan G, are coupons which General Mills induces a retailer to place in its own food advertisement. The consumer also redeems these at the store when purchasing cereals. General Mills reimburses the retailer for the cost of the coupon and gives it an additional allowance (Tr. 33,405, 33,425). Every General Mills product in national distribution since June 1968 has been promoted by either "retailer" or "manufacturer" coupons or a combination of both. From 1965 to 1968, when data for "manufacturer" coupons only is available, General Mills used coupons on products representing over 80% of its pound volume in every year but one (GMX 211, 225, 271, 564E–I).

388. General Foods similarly used coupons with the majority of its brands every year from 1965 to 1972. In 1965, all General Foods established cereals carried coupons except Sugar Crisp, Bran Flakes, Rice Krinkles and Raisin Bran. In 1966, coupons for Raisin Bran and Bran Flakes were added and, in 1967, coupons were distributed for Sugar Crisp and Rice Krinkles. From 1968 to 1970, General Foods used coupons with all of its cereal brands other than Crispy Critters and, in 1971, with all products except Crispy Critters and Honeycombs (GFX 1337 thru 1344).

389. Complaint counsel assert (CPF 8–165 thru 8–169) that

coupons were an ineffective means of promoting RTE cereal sales. However, the price incentive afforded by cents-off coupons amplified Kellogg's sales volume by inducing trial of cereal brands by non-users and by stimulating additional purchase by current buyers (Tr. 29,926–27).

390. Further, Kellogg emphasized their use in the early 1970's, at a time when other methods of promotion such as in-pack premiums and trade deals (conceded by complaint counsel to be very effective competitive devices (CPF 8–176 thru 8–179, 8–112 thru 8–115)) were available and widely used by Kellogg and the other respondents. For example, Kellogg's 1972–1973 Special K promotional strategy featured coupon promotion because of its effectiveness in promoting RTE cereal sales:

> Continue the pattern of in-pack couponing. This couponing can encourage increased consumption among current buyers and increase trial and re-trial (CX–K 7194M).

Kellogg's Mini-Wheats 1972–1973 "Promotion Strategy" likewise featured coupons:

> Stimulate trial and repeat purchase through the use of Mini-Wheats' in-pack coupons (CX–K 7201G). **[123]**

391. Consumers used over . . . of all Kellogg coupons distributed over the 1970–1972 period (derived from KX 80D, F *in camera*). This is a very high figure when it is realized that newspaper and mail offerings reach many people who are not potential customers of the cereal covered by particular coupons.

The pay back to consumers and cost to Kellogg from Kellogg's coupon promotions was substantial each year from 1966 to 1972.*

392. General Foods' 1967 Cereal Task Force recognized that couponing was "known effective:"

> (a) To generate trial among non or infrequent users.
> (b) To provide an incentive for current users to immediately repurchase or to purchase in extra quantity (loading).
> (c) To provide the Sales Force with an effective vehicle to sell against (CX–GF 4039Z–116).

The task force credited Post's 1967 national coupon campaign with generating substantial gains in market share for General Foods (CX–GF 4039Z–112). **[124]**

393. A consumer survey conducted for General Foods' Post Division in 1964 revealed that:

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* Chart titled "KELLOGG COUPONS AND CASH REFUND REDEMPTIONS 1966–1972" not reproduced herein, because data is *in camera*. (KX 80A, B *in camera*)

Among a number of different types of premiums listed, housewives overwhelmingly selected as the one which would be most likely to cause them to buy a cereal: "A coupon allowing you to make your next purchase more cheaply" (GFX 569E).

394. Not only was the use of couponing by respondents substantial, but it appears, as indicated by the following chart,** not to have been coordinated.

As shown above, there is no continuity of pattern for any individual respondent or correlation among respondents on coupon and cash refund redemptions from any one year to the next. **[125]**

395. Complaint counsel (CPF 8–167, 8–168) would downplay the importance of coupons. They assert that the redemption of 2.6% of Kellogg coupons distributed in newspapers, 3% of those distributed in magazines, 8% of those distributed by direct mail and 6% distributed inside cereal packages, and the 5% and 6% redemption rate anticipated by General Mills of a coupon being distributed through newspapers (CX–K 576B–E; KX 78; CX–K 5A; CX–GM 14C) is insignificant. I cannot agree. The respondents have apparently engaged in mass distribution of coupons and not all coupons are noticed. Further, not every recipient wants RTE cereals or the particular cereal involved. And many recipients will receive duplicated coupons through different media.

396. In assessing the amount of price reduction involved, complaint counsel would divide overall sales by the value of the coupons redeemed. Respondents, on the other hand, would divide the price of a particular cereal (say $.50) by the value of the particular coupon (say $.07) and reach a 14% price reduction. In Finding 394 above, I have presented the price reduction resulting from coupons in the manner advocated by complaint counsel. However, to the person who redeems a $.07 coupon on a $.50 item, the price reduction is 14%. And respondents have made this type of price reduction readily available.

(b) Private Label RTE Cereals

Complaint counsel allege (CPF 8–124, 8–137) that respondents tacitly agreed to avoid private label business; and that, as a result, they reduced private label product production and so limited their pricing discretion and removed a threat to the stability of their agreement to avoid price competition.

397. The term "private label RTE cereal," in its strictest sense, refers to RTE cereal sold under a retailer or wholesaler label (*e.g.*, Safeway Corn Flakes), in contrast with cereal sold under the

** Chart titled "COUPON AND CASH REFUND REDEMPTIONS AS A PERCENTAGE OF DOLLAR SALES 1965–1972" not reproduced herein, because data is *in camera*. (GMX 561A, *in camera*)

manufacturer's label (*e.g.*, Kellogg's Corn Flakes) (Tr. 11,549, 14,896). Private label RTE cereal generally is not advertised by the manufacturer and is sold to wholesalers and retailers at much lower prices than branded cereal sold under a manufacturer's label (Tr. 17,508–11).

398. "Controlled brand" RTE cereals are cereals sold under a manufacturer's label with no advertising support from the manufacturer (Tr. 13,697–98, 17,511). Controlled label cereals are distributed on a limited basis, generally to retailers too small to carry their own private label, and are priced at levels similar to private label (Tr. 13,700, 13,722–23; CX–GF 124A). As used here, the term "private label" encompasses private label and controlled brand RTE cereals.

399. The lack of advertising of private label RTE cereals enables manufacturers to price them lower than their branded counterparts. These lower prices are passed on by retailers in substantial measure to the consumer (Tr. 9001–02, 9338–39, 13,724, **[126]**17,505–26). Thus, private label products compete pricewise with branded products.

400. Ralston generally priced its private label products to give the consumer about a 10% saving over branded products. Retailers normally paid less than the price paid for the comparable branded product. Thus, retailers enjoyed about a 6% higher gross margin than on branded products (Tr. 17,509–11). General Foods priced its private label cereals by deducting the advertising and direct selling expenses of the comparable advertised brand. It then added the selling and brokerage expenses (CX–GF 121I–J).

401. Retailers attempt to capitalize on the price competition offered by private label RTE cereals by placing them close to their branded counterparts, so that their customers may choose the private label products on the basis of their lower prices (Tr. 9001–02, 9127–28, 9338).

402. Private labeling in the RTE cereal industry is much less extensive than in many other food product categories (Tr. 21,873–74; CX–CI 103). RTE cereal producers frequently use the "All Other" category reported by A.C. Nielsen as a basis for estimating the sales and market share of private label RTE cereals (Tr. 7414, 11,550–51; 12,947; CX–GF 121M). In 1943, the "All Other" category was 10.8% of total pound sales (CX 106A). This category declined to as low as 1.5% in 1967–1968 and never exceeded 3% after 1956 (CX 106).

403. Kellogg has never sold a private label RTE cereal product (Tr. 11,549, 12,655–69, 13,153–54, 27,927).[38]

404. In August 1943, Kellogg leased the facilities of Miller Cereal

[38] Consistent with this policy, Kellogg rejected requests from retailers during the period covered by the complaint (1950–1972) for private label RTE cereal products (Tr. 9016–19, 12,660–68, 13,153–54; CX–K 7054, 7148).

Company, which was primarily in the business of manufacturing and selling private label RTE cereal products. Miller produced several types of RTE cereals, including corn flakes, wheat flakes, 40% bran flakes and puffed wheat (CX–K 619). Kellogg discontinued Miller's private labels and began packing Kellogg brand cereals in the Miller facilities. The lease agreement contained an option to buy within 15 years, which Kellogg exercised in 1958. As a result, Miller was eliminated as an independent producer of RTE cereal products (Tr. 21,873; CX–K 444B, 619).[39]

405. Respondents, including Kellogg, are alleged to have engaged heavily in price competition prior to 1950. Kellogg's consistent **[127]** avoidance of private labels dating back over 40 years prior to 1950, including its discontinuance of private labels in the Miller facility in 1943, does not become suspect as a step in carrying out an alleged tacit agreement around 1950 not to engage in private label competition.

406. Like Kellogg, General Mills has never produced private label cereals (Tr. 15,933). Therefore, this practice, which long predated 1950, does not fit a time pattern from which it can be argued that there was tacit agreement not to engage in private label competition.

407. Both Kellogg and General Mills have maintained operations at a high level of capacity (Tr. 26,364, 27,155, 27,443, 28,236; CX 203). To the extent that excess capacity occurred, each company, as a matter of business policy, elected to utilize that capacity with newly developed branded products (Tr. 17,357, 17,866–67, 29,973, 33,134). Complaint counsel have failed to show that either Kellogg or General Mills had that degree of excess capacity over an extended period of time that would be necessary to enter into long-term commitments to provide private label products (*See* Tr. 13,787, 23,550–51; CX–GF 159B).

408. General Foods has produced private label RTE cereal products since at least 1937, when it sold about 100,000 pounds ($10,000) of private label RTE cereal (GFX 1370K).

409. In 1943, General Foods acquired the Jersey Cereal Company, with manufacturing plants in Irwin, Pennsylvania and St. Joseph, Missouri. Jersey produced a number of RTE cereals—including corn flakes, wheat flakes, bran flakes, rice flakes, rice gems, wheat puffs and rice puffs—some under its own name, but primarily under private labels (GFX 253F, 1370K).

410. General Foods purchased Jersey in order to acquire certain

[39] There is no evidence, or contention, that Kellogg acquired Miller with the intent of destroying private label competition.

patent rights, equipment and manufacturing knowledge, and to expand its private label business (Tr. 13,715–16; CX–GF 167Z–10, Z–11).

411. In 1947, after encountering problems in production, marketing and distribution, the private label business of General Foods showed an operating loss of $141,000 (CX–GF 121H).

412. In order to eliminate duplicative expenses and quality control problems, the plants at Irwin and St. Joseph were closed and their operations were transferred to Battle Creek (CX–GF 121G).

413. General Foods' private label business suffered further losses (CX–GF 121L). By 1953, General Foods had lost over $2 million (without full allocation of overhead costs) on its private label business since acquiring Jersey (GFX 1370L).

414. In order to save money in the marketing of its private label cereals, General Foods moved the responsibility for private **[128]** label sales from brokers to the General Foods sales division. Since this additional responsibility interfered with the sales force's marketing of General Foods' trademarked brands, responsibility for selling private label was shifted back to brokers (CX–GF 121F).

415. Around 1956, General Foods discontinued its business with what it considered "borderline private label cereal customers" whose volume did not justify the expense involved in supplying them (Tr. 13,729). This cut-back improved General Foods' profit situation on its private label products (CX–GF 121P).

416. General Foods continued to supply private label cereals to three principal customers—A&P, Kroger and American Stores. The Jersey control brand name was dropped in favor of private label sales (Tr. 13,730).

417. General Foods subsequently decided to discontinue its private label cereal operations as it was not considered to be a profitable business (Tr. 36,590). General Foods' 1967 Task Force had recommended discontinuance of private label operations, anticipating that the future demand for branded products would require the time, space, machinery and efforts then being devoted to private label (CX–GF 120B, 133A).

418. General Foods utilized its excess capacity in the production of new products (Tr. 13,656, 14,119, 36,591–93).

419. General Foods' private label cereal sales declined from a high of about 7 million pounds in 1955 to under 5 million pounds in 1960 and under 2 million pounds in 1970 (GFX 1370L). In 1966, General Foods' private label business was less than one-half of its 1949 level (CX–GF 121H–J, 152B). Its 1965 level was approximately

the same as its 1944 level of private label production (including Jersey) (CX–GF 121M).

420. Thus, General Foods, unlike Kellogg and General Mills, did make an effort to compete by offering private label products. For a time, it increased its private label production beyond the point previously reached by the company it had acquired, in part, for the purpose of producing private label. There is no evidence, or contention, that the acquisition was made to remove private label competition.

421. Relying upon a number of requests by retailers for private label products (CPF 8–154), Jersey's profitability in 1943, General Foods' profitability in the mid 1950's and Ralston's profitability on private label business (Tr. 17,501–10, 17,515–26), complaint counsel assert (CPF 8–156) that "respondents' excess capacity on production systems, the significant retailer demand for private label, and the profitability of producing private label, are factors that should have encouraged respondents to engage in private labeling activity. The absence of private labeling activity in the face of these incentives strongly indicates that respondents tacitly agreed to avoid competition by restricting output of private label products." **[129]**

422. As found above, however, neither Kellogg nor General Mills have been shown to have had sufficient excess productive capacity to engage in private label competition; and General Foods tried, but was unable to generate the returns deemed appropriate.

423. Complaint counsel's effort to second-guess the business judgment of respondents is made despite a failure to show that the sales and profit potential for private label products is greater than for branded products. It also flies in the face of an obvious disinclination of any company to private label its own products and so create competition for its own brands (Tr. 26,684, 28,365), as well as the difficulties in simulating the branded products of others (Tr. 9173, 17,556, 22,987–89, 25,857).

424. It is concluded, therefore, that complaint counsel have failed to establish that respondents' activities with respect to private label RTE cereals were in accordance with any agreement, tacit or otherwise; that respondents' activities reflected anything other than independent business decisions made in an effort to further legitimate business interests.

D. *Nonprice Competition*

Complaint counsel assert (CPF 8–170) that "[r]espondents did not limit their tacit agreement to avoid competition to pricing and

related areas. Rather, respondents also avoided other actions in the form of nonprice competition that might have led to price competition or that potentially might have threatened their goals of maintaining marketplace stability and maximizing profits at the expense of customers." Here, complaint counsel include in-pack premium competition, competition for shelf space allocation at the retail level, competitive advantages by fortifying products and the exchange of data covering current advertising expenditures, as means of reducing marketplace uncertainties which otherwise might result in more active competition.

Respondents' activities with regard to in-pack premiums have been considered above as a price-related activity (Findings 363–83). We shall now consider the exchange of advertising expenditure data, shelf space competition and product fortification. The additional, but related, subject of competition in the introduction of new products will also be considered.

1. *Advertising*

425. Since before 1950, all three respondents and Quaker, Ralston, and Nabisco each submitted to A.C. Nielsen Co., usually through their advertising agencies, their brand-by-brand advertising expenditures for network and spot television, network radio, **[130]** newspaper, and magazine advertising for the two months prior to submission (Tr. 11,842–43, 15,596–97, 15,600–01, 15,641; CX–ACN 2; KX 14). Using this data, Nielsen prepared a bi-monthly report which detailed total advertising expenditures broken down by media for each brand of each company and, within seven weeks of the end of the bi-monthly period covered by the report, supplied it to the respondents and the other participating RTE cereal producers (Tr. 14,232–33, 14,354, 14,356–58, 14,953–54, 15,597–99; CX–GF 4010Z–35, Z–36; CX–GM 176).[40]

426. Complaint counsel assert (CPF 8–238) that this exchange of advertising information has served to allow respondents to prevent "an expensive advertising war."[41] However, there is no evidence that the respondents utilized the information to curtail or otherwise coordinate their advertising efforts. To the contrary, the record shows that industry members competed very strongly against each other in their advertising endeavors.

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[40] General Mills did not participate in 1950 and for some six years thereafter (Tr. 15,615–16).

[41] This assertion is inconsistent with the further assertion (CPF 11–183, 11–205) that respondents have engaged in excessive and wasteful advertising.

427. Total advertising expenditures for the five largest producers increased from $23 million in 1950 to $84 million in 1971.[42] In addition to this absolutely large amount, advertising also has been substantial in comparison to sales. The advertising to sales ratio in the RTE cereal industry exceeded 10%, sometimes by a substantial amount (Tr. 21,905, 27,676; CX 513). This is substantially higher than for most other industries. Of more than 320 manufacturing industries, the advertising-to-sales ratio in the RTE cereal industry was among the two highest (Tr. 21,904, 27,678).

428. Total advertising for the three respondents went from $19.5 million in 1950 to over $86 million in 1967. During that **[131]**period, Kellogg's yearly advertising expenditures grew from $8.5 million to more than $40 million. General Mills' went from $5.4 million to $25.7 million. General Foods' went from $5.6 million to $19.5 million (GFX 1319; CX–GF 324J).

429. Advertising expenditures of those firms which furnished advertising data to Nielsen have varied widely (GMX 555). During the period 1958–1972, General Mills' advertising expenditures as a percentage of dollar sales were over 30% higher than Kellogg's in 10 of the 15 years, and were over 20% higher in four of the remaining five years. On the other hand, General Foods' advertising expenditures varied from being 33% less than General Mills' in 1961 to 23% higher than General Mills' in 1970. Quaker's advertising expenditures were twice as high as Kellogg's in 1971 and were never lower than Kellogg's; Ralston's advertising expenditures were never lower than 28% above Kellogg's; and Nabisco's varied from 57% higher to 14% lower.[43] None of the firms followed Kellogg, the alleged industry leader. The following table, derived from GMX 555, depicts advertising expenditures as a percentage of dollar sales, using Kellogg's expenditures as the benchmark (at 100%).

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[42] These expenditures, in millions of dollars, are as follows (CX 506B):

	1950	1971
Kellogg	8.5	32.9
General Mills	5.5	24.0
General Foods	6.4	16.1
Quaker	1.8	8.2
Nabisco	1.2	3.0
Total	23.4	84.2

[43] These figures are all advertising expenditures as a percentage of dollar sales.

INDEX OF ADVERTISING EXPENDITURES
AS A PERCENTAGE OF DOLLAR SALES
1958–1972

Year	Kellogg	General Mills	General Foods	Quaker	Ralston	Nabisco
1958	100.0	126.8	110.4	149.8	144.5	157.1
1959	100.0	130.9	92.4	113.8	139.4	100.5
1960	100.0	107.2	91.1	127.6	182.2	86.1
1961	100.0	131.6	88.1	182.2	191.9	99.2
1962	100.0	121.2	96.7	168.0	189.3	104.7
1963	100.0	135.3	100.7	140.7	170.0	126.7
1964	100.0	132.6	111.6	132.4	152.3	135.3
1965	100.0	134.7	112.1	131.3	127.4	131.3
1966	100.0	126.0	133.5	128.2	138.9	140.9
1967	100.0	133.0	142.0	129.1	141.7	112.1
1968	100.0	142.8	152.6	174.0	134.4	122.2
1969	100.0	132.8	127.3	133.6	145.7	86.7
1970	100.0	124.8	154.2	155.0	174.4	88.4
1971	100.0	130.6	150.6	200.6	NA	115.5
1972	100.0	157.2	146.8	139.7	NA	138.4

NA - Data not available [132]

430. The following table shows advertising expenditures as a percentage of dollar sales for the three respondents:

ADVERTISING EXPENDITURES
AS A PERCENTAGE OF DOLLAR SALES
1958–1972

Year	Kellogg	General Mills	General Foods
1958	14.57	18.47	16.09
1959	17.23	22.56	15.92
1960	16.26	17.43	14.81
1961	15.42	20.15	13.49
1962	15.21	18.43	14.71
1963	15.19	20.57	15.30
1964	15.23	20.19	16.99
1965	16.61	22.38	18.62
1966	15.72	19.81	20.98
1967	15.56	20.69	22.09
1968	12.08	17.25	18.43
1969	12.09	16.05	15.39
1970	10.60	13.23	16.34
1971	9.74	12.72	14.67
1972	9.39	14.76	13.78

(GMX 555A)

431. As the above tables demonstrate, Kellogg's, General Mills' and General Foods' expenditures on advertising followed markedly different and varying patterns during the period 1958–1972. [133]

432. Advertising expenditures on individual products have also

varied greatly. An examination of pairs of brands that Dr. Green studied in looking for brand pricing coordination fails to show parallel or coordinated advertising spending by respondents (*See* GMX 242–49). This is demonstrated by the following examples:

ADVERTISING TO SALES RATIOS FOR SELECTED PRODUCT PAIRS

A/S Ratio		A/S Ratio		A/S Ratio		A/S Ratio	
General Mills' Total	Kellogg's Product 19	General Mills' Cocoa Puffs	Kellogg's Cocoa Krispies	General Mills' Cheerios	Kellogg's Rice Krispies	General Mills' Trix	Kellogg's Froot Loops
–	–	.281	1.181	.132	.137	.188	–
–	–	.278	0.353	.147	.139	.141	–
–	–	.144	0.316	.159	.142	.170	–
–	–	.160	0.185	.161	.151	.147	–
.426	–	.102	0.130	.148	.148	.140	–
.196	–	.145	0.136	.160	.138	.157	–
.224	–	.124	0.159	.147	.134	.170	.211
.224	–	.145	0.155	.152	.132	.158	.157
.182	.627	.162	.106	.152	.115	.168	.094
.189	.336	.143	.087	.148	.126	.142	.060
.169	.308	.102	.113	.123	.125	.091	.097
.156	.176	.104	.073	.119	.094	.112	.062
.182	.200	.109	.051	.099	.095	.096	.045

(GMX 244, 245, 247, 248) **[134]**

433. Complaint counsel, purporting to rely on Mr. Glassman and Dr. Schmalensee (Tr. 22,469–71, 27,131–33) contend (CRPF 8–283) that such comparisons are not persuasive; that advertising-to-sales ratios would have to be adjusted for the introduction rate of new products before comparisons would be meaningful. Such an adjustment might well affect the comparison of overall advertising-to-sales ratios. However, it is compliant counsel's speculation that advertising expenditures may have been coordinated. And so it is complaint counsel's burden of proof that has not been met. In any event, complaint counsel's objection is inapplicable to the comparisons of advertising for the individual pairs of products selected for comparison by complaint counsel's own witness, Mr. Glassman.

434. Those economic experts who addressed themselves to an evaluation of advertising expenditures (both those introduced by complaint counsel and those introduced by respondents) agreed that there was no evidence of parallel or coordinated advertising endeavors by respondents (Tr. 22,467–68, 27,129–32, 38,565–66, 38,570, 38,622).

435. Complaint counsel assert (CPF 8–237) that "the mutual exchange of detailed advertising data permitted the respondents to make . . . [reductions in advertising expenditures in the late 1960's]

without fear of losing market share because each was able to coordinate its reduction with the others;" and that (CRPF 8–276) "without such an exchange, respondents may not have been successful in sharply reducing advertising expenditures in the late 1960's." This, however, is pure conjecture.

436. Respondents' executivies testified that no such arrangement was made (Tr. 29,725, 29,727, 32,768, 35,462–63, 35,815). And there is no evidence tending to establish the existence of any such agreement. The tables indicating lack of coordinated action and the evaluative testimony of expert witnesses to the effect there was no such coordination, referred to above, covered the late 1960's period in question. Further, there is no basis for complaint counsel's conjecture with regard to an exchange of advertising information instituted some 20 years before the downturn in advertising.

437. While total advertising expenditures in the RTE cereal industry declined in the late 1960's, this was largely in response to the slowing of RTE cereal market growth. RTE cereal sales reached 1.177 billion pounds in 1965, but then leveled off, reaching only 1.190 billion pounds by 1971 (CX 101E).

438. In 1968, General Foods reversed its long-term trend of advertising expansion and sharply reduced its advertising spending by more than $3 million (GMX 241). This was after the 1967 General Foods Task Force had recognized the decline in market growth and anticipated the continuing absence of RTE cereal market growth in planning its late 1960's marketing strategy (CX–GF 4039V). Further, General Foods was shifting its marketing emphasis away from advertising to individual product promotions as part of its **[135]** withdrawal from a full line advertising strategy to that of pushing individual brands (Tr. 27,369, 36,405–06; CX–GF 4039Z–114, Z–115). Overall advertising and promotional expenditures of General Foods for 1966 through 1970 showed no decline (GFX 24).

439. Advertising is expected to decline in a competitive industry as sales growth stops (Tr. 27,368–69, 38,566–67). There is nothing suspect, therefore, in the fact that Kellogg's and General Mills' advertising had begun to decline by 1968, and that advertising of Quaker, Ralston, and Nabisco also declined between 1967 and 1969 (GMX 241; GFX 1319).[44] Apart from a uniformity in decreasing the percentage of advertising expenditures in 1968, the following table, taken from GMX 241, shows a disparity of action on the part of respondents both before and after that year:

[44] As previously found (Findings 330–33, 349, 352, 353, 383) respondents' use of various product promotions increased as their advertising decreased.

ANNUAL ADVERTISING EXPENDITURES BY COMPANY, AND PERCENTAGE CHANGE FROM PREVIOUS YEAR 1964–1972

	Kellogg		General Mills		General Foods	
	($000)	% Change	($000)	% Change	($000)	% Change
1964	35,363		19,751		14,886	
1965	39,071	+ 10.5	25,017	+ 26.7	16,115	+ 8.5
1966	40,212	+ 2.9	22,404	− 10.4	19,419	+ 20.5
1967	40,877	+ 1.7	25,619	+ 14.4	19,486	+ .4
1968	33,847	− 17.2	21,029	− 17.9	16,463	− 15.5
1969	36,190	+ 6.9	21,085	+ .3	14,100	− 14.4
1970	32,740	− 9.5	18,750	− 11.1	15,399	+ 9.2
1971	32,853	+ .4	18,130	− 3.3	16,098	+ 4.5
1972	32,988	+ .4	24,018	+ 32.5	16,076	− .1

440. General Mills examined the marketing expenditures on a competitive product and its sales volume in order to evaluate what might be working or not working for a competitor in comparing the sales results of General Mills' own advertising efforts. There was no attempt to match spending levels (Tr. 15,945–49, 17,651–52, 17,656). Advertising spending levels for individual products were based on the recent and projected sales performance of the product, its recent advertising levels, its responsiveness to advertising and its existing or targeted consumption profile (Tr. 17,651, 17,303, 17,391). **[136]**

441. Kellogg, General Foods, and Quaker also used such advertising information to correlate advertising efforts with sales results, and so evaluate advertising efficiencies. Quaker and General Mills used sales and advertising data to project their own sales volumes (Tr. 12,804–05, 14,233, 14,953, 14,976, 15,771).

442. While competitors' levels of advertising expenditure were considered by respondents in setting advertising budgets for their cereal brands, they were not a controlling factor (Tr. 12,367, 15,243–44, 17,174, 17,651–53, 17,656, 29,712).

The complaint charges respondents with having maintained and utilized monopoly power. The exchange of advertising data has not been alleged as a violation of law. Therefore, the failure to show that such an exchange was utilized for monopolistic purposes constitutes a failure or proof under the instant complaint.

443. It is concluded that respondents engaged in very heavy advertising as a means of competing in the sale of RTE cereals. It is concluded further that, while respondents exchanged advertising data, such data was employed for legitimate business purposes, and that there is a lack of evidence to support complaint counsel's

speculation that the data exchanged was used to parallel or coordinate advertising endeavors.

2. *Competition For Retail Shelf Space*

444. Complaint counsel assert (CPF 8–170, 8–189, 8–204) that respondents had a tacit agreement to avoid competition for shelf space in retail stores; that this was accomplished by Kellogg formulating and implementing a shelf space allocation plan and General Mills and General Foods acquiescing in that plan. General Mills and General Foods executives have denied the existence of any such agreement or conspiracy (Tr. 32,712–13, 35,462, 35,815, 36,527). The record furnishes no basis for not accepting this testimony.

445. Normally, the RTE cereal section in a store comprises most, if not all, of one side of an aisle (CX–K 553J; Tr. 6523, 6560–61, 7291, 7607–09, 8308–11, 8818–22, 9062–65, 9070–71). As of November 1961, there were over 100 brands and sizes of RTE cereal products from which the retailer selected about 75 to 90 to be displayed (CX–K 553J; KX 3). In shelving these products, decisions must be made on where to locate each RTE cereal and how many "facings" (*i.e.,* the space needed to place one RTE cereal package broadside on the shelf with the front panel of the package displayed) each is to be given. Additional packages are placed in a row behind each front facing (Tr. 8090–92, 8346–47).

446. Apart from preventing out-of-stocks, there is a degree of relationship between sales volume and the amount of space an RTE **[137]**cereal product receives on the shelf (Tr. 8817). The location of the RTE cereal product on the retail shelf is also a factor in promoting sales (CX–GF 4039Z–12; *see also* CX–K 95A, 135C, 547H–J; CX–GM 148, 704; CX–GF 324C, 0, S, 325P, 0, L, 560–560A; QX 21 aka CX–K 108; GMX 7B, C aka CX–GM 152B, C). Traffic patterns are considered in selecting preferred locations (Tr. 9048–56; CX–K 556D, E). Either end of the aisle (Particularly the end reached last) is considered less desirable, and respondents usually preferred the center of the gondola where visbility to a consumer is normally the best. Also, a center location permits an expansion of space in either direction (Tr. 6520–23, 7210–11, 7283, 7291–93, 7695–96, 8233–35, 8313–15, 8750, 8820, 8949–50; CX–GM 148C).

447. Preferred locations would frequently vary from store to store, depending upon traffic patterns (Tr. 7684–86, 8121–24). General Foods tried to have its products shelved next to Kellogg's with its Post Toasties next to Kellogg's Corn Flakes (Tr. 8820).

448. Many of respondents' officials believed that grouping a

company's products together increases the manufacturer's opportunity to capture the customer's attention and, therefore, his impulse purchase (Tr. 6503, 6521–23, 6558, 7646–48, 8100, 8113–15, 8819).

449. There is a conflict in the evidence with respect to the importance of impulse purchases. General Mills executives testified that most RTE cereal purchases are planned and that the space allocated for a cereal may affect the time spent by the consumer searching for it, but will not have an impact on the product's sales (Tr. 7829–34, 8022, 8097, 8176–77). On the other hand, General Foods' 1961 marketing plan contains a reference to recent studies showing that 71.8% of all cereal purchases at the store level are made on impulse (CX–GF 324S). Since the studies are not identified and respondents in 1976 (when the exhibit was received) had no opportunity to cross-examine any witness with respect to the unidentified pre-1961 studies, the 71.8% estimate cannot be accepted as an accurate figure. Further, if RTE cereals were primarily impulse purchase items, respondents would not be making the immense advertising and promotional expenditures that they are to presell their products (*see, supra,* Findings 427, 428, 430, 439); and Dr. Scherer (and other economic experts) would not have felt required to make adjustments for advertising persistence rates when converting accounting rates of return to economic rates of return (*see, infra,* Findings 682, 685–87, 700, 768–91).

450. Before Kellogg developed its shelf space plan in the 1950's retail grocers varied in their methods of shelving RTE cereal products. Some would group cereals by grain, *i.e.,* corn-based products together, wheat-based products together, oat-based products together, rice-based products together, etc. Some retailers would group cereals by types, *i.e.,* presweetened cereals together, unsweetened cereals together, etc. Other retailers used other methods of shelving, including grouping by manufacturers (Tr. 6504–05, 6514–15, 8018, 8084, 8113, 32,675, 32,722). Also, most RTE cereal brands were accepted by most large retail outlets and few RTE **[138]**cereal products were allocated more than a minimum number of facings on the shelf (CX–K 553I, J, K). This meant that Kellogg, whose products were the largest sellers, was not getting its proportionate share of shelf space and that there were out-of-stocks of Kellogg products.

451. As grocery stores were changing from over-the-counter to self-service, Kellogg salesmen in particular, as representatives of by far the largest cereal producer, were called upon by retailers to offer shelf placement recommendations (Tr. 36,818). In 1956, Kellogg developed a standard Kellogg approach to shelf placement recom-

mendations. Space according to sales and company grouping were the two key elements of the Kellogg program (Tr. 6474, 6501).

452. Starting in 1956, and thereafter, Kellogg made recommendations to retailers about how to organize their cereal shelves using these two principles. The recommendations covered the products of all major manufacturers because retailers needed to see how the whole section would look (Tr. 6474, 6501, 6503–04, 6514). The same two general principles governed Kellogg's use of its "Magnaboard" (a mock-up of a cereal shelf with movable parts representing individual cereal brands) introduced in the early 1960's (Tr. 6542–43).

453. Sometime in the late 1960's, Kellogg computerized its shelf space plan. Where the plan was accepted, the retailer supplied Kellogg with its own sales data for each product (Tr. 6657). The computerized Kellogg shelf space plan, called Computerized Space Allocation ("CSA"), consisted of two phases. In Phase I, Kellogg recommended a change in the case size ordered for each cereal. The recommendation was usually to lower the case size pack of competitive products, which resulted in a reduction in facings for such products (Tr. 6943, 7114; CX–K 1063).

454. As part of Phase I, Kellogg recommended which items should be discontinued. It generally recommended that a product be discontinued when its share was less than .5% of all RTE cereal sales, or when the product was selling only four to five packages per week. However, the particular cut-off for discontinuance of a product, or of a size of a product, varied by account in accordance with what would minimize Kellogg's losses and maximize competitive losses. In all cases, an attempt was made to maintain distribution of Kellogg products. Discontinuance of a Kellogg product would be recommended only if it could take a number of competitive products with it (Tr. 6807–08, 7124–25). Phase II of the Kellogg program allocated the shelf space among the remaining cereals by volume (CX–K 1065).

455. Kellogg's shelf space efforts and strategies were designed to create more sales for Kellogg at the expense of its rivals (CPF 8–187, 8–191, 8–196, 8–204; Tr. 6501–03). The primary purpose underlying Kellogg's shelf space program was to reduce Kellogg out-of-stocks and get more retail shelf space for its RTE cereal products. Kellogg's share of shelf space and inventory historically **[139]**had been less than its share of sales. Thus, the principle of sales according to shelf space enhanced the placement of Kellogg's products at the expense of those produced by its competitors (Tr. 7095, 7103–06, 7285, 8758, 8769–70).

456. Kellogg recommended that retailers shelve RTE cereal

products in company groupings so that Kellogg's lower volume products would be next to its high volume products and gain increased sales as as result of impulse purchases (Tr. 6501–04, 6521–23, 7662–68, 7744, 7821–24, 8090–92).

457. Kellogg, therefore, unilaterally instituted a shelf space program which was designed to afford it a competitive advantage over other RTE cereal manufacturers, including the other respondents. There is no reason to believe that General Mills or General Foods was party to the institution or implementation of Kellogg's plan.

458. Kellogg's shelf space program was one of making recommendations to the retailers. The retailers made their own decisions on how to shelve RTE cereals (Tr. 6527, 6762, 7121, 7146, 7149–50, 7208, 7210, 7669, 7687, 8266–67, 8274, 8494, 8840–41, 8893–94, 8910–11, 8917–18, 9039, 9092–96, 9112, 9115, 9364–69, 29,960–61, 29,964, 36,342–43). To the extent retailers adopted Kellogg's recommendations, they did so because such recommendations served their own profitability and efficiency interests (Tr. 8904–07, 9032–33, 9136, 9377–78).

459. Kellogg's shelf space allocation principles were followed in a majority of retail outlets (CX–K 553Q, 556C–G), although utilization of Kellogg's CSA computerization service was not as universal (KX 1–2). The principles appear to have been adopted because they were consistent with, and in the best interests of, the retailers.

460. The principle of space according to sales ensured that the retailers would avoid out-of-stocks and over-stocks, increase their efficiency and profitability and reduce labor costs (Tr. 6540–42, 6694, 6722–23, 7151, 7206–07, 8904–07, 8906–07, 9032–33, 9136, 9377–78, 32,746, 36,813). Consequently, the retailer would achieve a better utilization of its capital and a better return on its investment (Tr. 7109, 7606–07, 32,700–01).

461. Kellogg did not invent the principle of allocating shelf space by sales volume (Tr. 7213). Sales volume is, and has been, the basic method of space allocation throughout grocery stores. A retailer's profitability is directly related to sales turnover. The allocation of shelf space according to sales volume reduces the likelihood that a product will be out of stock, maximizes turnover and return on investment and minimizes lost sales and lost profit both to the retailer and the manufacturer (Tr. 6540–41, 7085–86, 8010–11, 8021–22, 8091, 8838–39, 8904–05, 9032–33, 9135–37, 9195–97, 9377–78, 32,745–46; CX–NCFM 500 at 222).

462. As Kellogg's Director of Marketing Research testified (Tr. 7085): **[140]**

[P]rofitability in the operation of the cereal department revolves around turnover, the amount of stock that has to be carried, labor costs in placing the items on the shelf and, to be more specific, profitability, if you will take, for example, the item turnover, by allocating space according to sales, what that tends to do is to reduce the day's supply on the slower selling items and increase it on the faster selling items, and consequently increases the sales on those faster selling items because it decreases the out-of-stocks.

So what you have got is a better return on investment because your merchandise is turning over faster in total. In the backroom stock, I noted earlier that backroom stocks have diminished over the years. In fact, today, the backrooms don't anywhere near resemble what they used to be in the 1950's. Very little backroom stock is given for any product on the shelf and especially cereals.

By reducing the backroom stock the retailer has tended to reduce his investment. Therefore he is selling more goods today than he ever did before with less stock and therefore he is making more money.

463. Shelf placement by manufacturer was commonly used by retailers for a wide variety of goods other than RTE cereals (Tr. 8762–67, 8847–55, 9036–39, 9098, 32,727–29). Retailers believed that grouping products by manufacturer served both the consumer's best interests as well as their own. It was the most efficient arrangement from the standpoint of the consumer's ability to locate quickly the RTE cereals he or she was looking for (Tr. 8,113, 8888, 9032–33, 9035–36, 9039, 9136, 9377–78, 32,727). This system facilitated inventorying and ordering because the stores' order guides were arranged by manufacturer (Tr. 32,726).

464. To the extent that other arrangements, such as stocking by grain type, have been tried, they were unsuccessful (Tr. 9039, 9139–40). Each RTE cereal has many characteristics important to the consumer and no single one can be effectively used as a basis for grouping. Grain, for example, is not a workable basis for grouping because there are many multigrain cereals and because grain is not always the most important feature to the consumer (Tr. 12,684–87, 12,694, 12,717, 32,727). **[141]**

465. Faced with Kellogg's shelving program which advocated space according to sales and grouping by manufacturers, which principles were logical and advantageous to retailers, as well as ones to which retailers were accustomed, it is not surprising that General Mills and General Foods advocated the same guidelines as they competed for shelf space (Tr. 7765–67, 7781, 7789–91, 8020–31; *See* CX–GM 148; GMX 7, CX–GF 560, 4039Z–86).

466. While all three respondents generally advocated shelving by manufacturer and allocation of space according to volume, they each still competed for all the space it could get. This included efforts to get more than a "fair share" of shelf space if its credibility would not be impaired by doing so. And each recommended the discontinuance

of slow moving products of its competitors (Tr. 6548, 6565, 6808, 7126, 7279, 7644, 7653–54, 7660–61, 7669–72, 7721–22, 7745, 7659–60, 7670, 8003–05, 8038–39, 8132–33, 8376–77, 8619–20, 8841–42, 8623–24, 9145–46, 9171–72, 32,699–701, 32,707–11, 32,713–15, 32,720, 32,736–37, 36,526–27, 36,820–21, 36,892–94).

467. General Mills recommended space allocation by sales volume only where this would lead to an increase in shelf space for General Mills at the expense of its competitors (Tr. 8004–06, 32,698–99). Generally, it tried to take the additional facings needed from Kellogg and General Foods, because products of those companies presented the heaviest competition to General Mills (Tr. 32,699–702).

468. In retail accounts where General Mills had a share of total RTE shelf space which was greater than or equal to its share of sales in the region, it recommended space allocation according to sales volume only for those products and sizes which had a share of shelf less than share of sales (Tr. 8005, 8054–56, 32,705–06).

469. Recommendations to increase facings beyond share of sales could not be justified as being in the economic self-interest of the retailer, and would not sit well with him. Such recommendations would have an adverse impact on the salesman's credibility (Tr. 8918, 9081, 9179–80). Thus, a respondent's failure to recommend space beyond that indicated by volume is not an avoidance of competition, but is totally consistent with competition and the respondent's economic self-interest.

470. For its items which already had shelf space equal to or greater than sales, General Mills aggressively used other strategies, such as promotions and displays, or attempts to get the retailer to accept a second size of the product (Tr. 8005, 32,704–05). If successful, such efforts would increase sales. Once sales increased to the point where share of market was greater than share of shelf space, General Mills would recommend an increase in facings based upon the principle of space allocation according to sales volume (Tr. 8005, 32,704–05).

471. General Foods' salesmen sought to have its cereals shelved where they would get the most exposure, preferably some distance down **[142]**the aisle in order to afford customers easier access (Tr. 8814, 36,797). At the same time, however, a salesman could not make ludicrous proposals that would destroy rapport with the grocer and his credibility as an advisor, *e.g.*, that Kellogg's cereals should not be shelved at all, or should be shelved at an inconvenient location, despite their relatively greater consumer popularity (Tr. 8918, 9179–80, 36,791–92).

472. In 1968, General Mills developed a more formalized shelf

space program (CX–GM 148). It was entitled Cereals Organized for Profit ("COP"). General Mills' COP kit was developed as a partial response to the Kellogg computerized shelf space program, which Kellogg came out with in the late 1960's (Tr. 32,717–18). The main selling point for COP was that it used regional market share figures to allocate facings on the cereal shelf as opposed to share data based solely on sales by the particular account, as the Kellogg plan did. For example, if Cheerios enjoyed a 5% share in a region, but only a 4% share in a particular grocery chain, General Mills would urge the retailer to increase Cheerios' facings to its regional share level of 5% (Tr. 32,718–19).

473. The COP kit was a sales aid which allowed salesmen to simulate an RTE cereal aisle. The kit, as distinguished from the use of sales and shelf facings data, was generally used only when a complete reset of the cereal section was contemplated. This was usually only once a year, because it required a lot of preparation time on the part of the General Mills salesmen. The kit was abandoned as a clumsy sales aid, but General Mills continued to vie for shelf space (Tr. 32,719, 32,717–22).

474. From 1955 to 1965, Nielsen market share data was utilized by General Foods to recommend space allocation to retailers. Toward the end of that period, warehouse withdrawal figures were used in place of Nielsen data when requested by retailers (CX–GF 560). Thus, the General Foods plan, unlike Kellogg's program, recommended that a manufacturer's products be placed on the shelves in proportion to that manufacturer's market share rather than its share of sales in the particular store.

475. In 1955, all General Foods cereal packages were redesigned to achieve a "family resemblance," and line packaging was emphasized (GFX 1255 O, 1256W, 1288F). Accordingly, General Foods salesmen were advised to try to get all General Foods cereals shelved together to create a "billboard effect" and to stress the line of products (Tr. 36,346, 36,809).

476. By 1956, the Post Planned Shelving Program had taken shape. It advocated: (a) space according to sales as measured by A.C. Nielsen; (b) shelving by company; and (c) General Foods cereals **[143]** in the middle of the cereal section with Post Toasties next to Kellogg's Corn Flakes (CX–GF 4039Z–86).[45]

479. While the Planned Shelving Program continued to provide the basic framework for General Foods' shelf activities, in April 1964, General Foods introduced "Compact Packages" (GFX 1304A).

[45] At one point in the 1960's, General Foods experimented with recommending grouping RTE cereals by grain. However, the plan was a failure (Tr. 8630, 8814, 9140).

Compact Packages were resized versions of existing cereal packages, designed to hold equivalent quantities of cereal in smaller boxes (Tr. 36,841).

480. These new packages were intended to appeal both to consumers and to the grocery trade (Tr. 36,386–87). The anticipated consumer benefits were: (a) a better fit on home cupboard shelves; (b) greater stability; and (c) easier handling. The anticipated trade benefits were: (a) better space utilization, *i.e.,* more cereal in the same amount of shelf space; (b) greater package stability; and (c) better pallet patterns (GFX 1304B, C).

481. General Foods anticipated increased sales and profits arising from (a) consumer preference for, and therefore purchase of, the new packages relative to the other manufacturers' old-style packages, and (b) increased distribution of General Foods cereal brands by placing additional items in the section of cereal shelves where its cereals were placed (Tr. 36,391–92, 36,837). General Foods also anticipated a benefit from being perceived by the trade as a leader in innovative cereal shelving, and thereby being able to secure greater acceptance for its shelving recommendations (Tr. 36,841).

482. After an advertising campaign and promotional efforts (Tr. 36,391, 36,393, 36,839–40), General Foods' compact packages made an initial favorable impact, and it gained some additional facings. Over time, however, the program was a failure, and General Foods ended up losing shelf space (Tr. 36,392–93, 36,841–42; GFX 1301).[46]

483. In 1965, General Foods terminated the Compact Packages program and returned to larger packages (Tr. 36,831; GFX 1310, 1324).

484. In 1971, General Foods developed and introduced C.O.M.P.A.S.S. (Customer Oriented Method of Profitability and Sales Service), a computerized system for making shelf space allocation recommendations on the basis of product profitability (GFX 1371). **[144]**

485. This effort was undertaken because some of the Post Division's most popular products (*e.g.,* Post Grape Nuts, Tang breakfast drink, Gaines dog food) were packaged in relatively smaller containers when compared with competing products in the same category. Therefore, they were assigned relatively few linear feet of shelf space by retailers, although their profitability per linear foot was relatively high (GFX 1371B).

486. Preliminary presentations of the C.O.M.P.A.S.S. system

[46] Grocers, instead of stacking additional General Foods cereals in the newly available space, continued to allocate facings according to sales and so placed other manufacturers' products in some of the space where General Foods cereals had been (Tr. 36,842).

were made to a few selected major accounts (GFX 1371C). The accounts' reactions to the presentations varied (GFX 1371D).

487. The Post Division staff concluded that the trade's reaction to C.O.M.P.A.S.S. justified further development. During the summer of 1971, the program was further developed and a C.O.M.P.A.S.S. Manual was distributed to Post Division salesmen (GFX, 1236, 1372D).

488. Efforts with C.O.M.P.A.S.S. continued throughout 1971 and 1972 (GFX 1371E). However, attempts to use the C.O.M.P.A.S.S. program as a sales tool to gain additional RTE cereal shelf space for General Foods products were largely unsuccessful, as few retail accounts were willing to provide the data necessary to permit a C.O.M.P.A.S.S. analysis of their RTE cereal sections. It was the consensus among the Post Division sales personnel directly involved in the development of C.O.M.P.A.S.S. that three principal factors explained the low level of interest among retailers in using it for their RTE cereal sections: (a) grocery retailers were generally satisfied with the results of their allocating cereal shelf space on the basis of movement, (b) some retailers had their own internal information systems which provided the same information as C.O.M.P.A.S.S., and (c) many retailers were not sophisticated enough to understand the concept underlying, or the potential benefits of using, C.O.M.P.A.S.S. (GFX 1371E).

489. Respondents' shelf space programs do not preclude new products from being allotted space. Procter and Gamble was not concerned over its ability to secure shelf space for an RTE cereal product it might introduce (Tr. 25,836–37, 25,864–65). When natural cereals became popular, adequate space was available for these products (Tr. 25,922–25, 37,324–25, 37,312–15). Kellogg's program provided for two facings for a new product (Tr. 7158–59). Slower moving products often were allotted a larger share of shelf space than their share of the market called for (Tr. 8017–20, 9057–58, 9177–79, 9379, 32,737–38). There is no evidence that position on the shelf is of such importance that it would stop a new entrant. While some positions are better than others, there is not a truly bad spot in the total RTE cereal aisle (Tr. 9175–76).

490. It is concluded, therefore, that the record does not support complaint counsel's assertion that respondents had a tacit agreement to avoid competition for shelf space in retail stores. Kellogg independently formulated a shelf space allocation plan that incorporated principles which were in accord with retailers' preferred methods of doing business. The other respondents, faced **[145]**with the same requirements of retailers, responded with plans that

incorporated the same basic principles. While each respondent competed for the most favorable shelf location and the most space it could get, it was constrained not to push for more than a reasonable share in order to maintain rapport and credibility with retailers. Nevertheless, both General Mills and General Foods did present shelving alternatives and variations in an effort to gain competitive advantages.

3. *Fortification of Cereals*

491. Complaint counsel assert (CPF 8–170): "Widespread product fortification was avoided until outside pressure forced the respondents to fortify their cereals. Even then, fortification occurred only as a result of coordinated activity, thereby ensuring that no one of the respondents would gain a competitive advantage by introducing fortified products before others were prepared to fortify their cereals." And (CRPF 8–264): "[R]espondents agreed upon fortifying their RTE cereal lines in concert." The record does not support complaint counsel's assertions of agreement and coordination.

492. The addition of vitamins, minerals or other nutrients to cereal products is described as "fortification" or "restoration." Restoration is the replenishment to whole-grain levels of naturally-occurring nutrients lost during processing. "Fortification" is the addition of nutrients in amounts greater than those occurring in the whole grain, or of nutrients not naturally found in the grain (Tr. 29,714, 35,807).

493. The Council of Foods and Nutrition of the American Medical Association issued standards on the addition of nutrients to foods as early as 1939. These standards were to the effect that there were both nutritional and economic problems associated with the supplementation of food with specific nutrients, since supplementation might be wasteful and might have deleterious effects. This position was reaffirmed in 1946, 1953, and 1961. The last two times the position was announced in conjunction with the Food and Nutrition Board of the National Research Council. In May 1961, the two groups issued a joint policy statement which recommended that nutrients be added to foods only to the extent of restoring those which were contained naturally in the food item, but which had been lost by cooking during part of the manufacturing process. It was specifically recommended that the addition of nutrients to RTE cereals be limited to the "restoration" of the naturally occurring nutrients (GMX 540).

494. Consistent with these standards, Kellogg has added thi-

amine, niacin, riboflavin and iron to restore its cereals to whole-grain levels ever since 1941 (Tr. 11,806–07, 29,714, 29,948). Similarly, General Foods restored most of its RTE cereals to so-called whole-grain levels with essential B vitamins and iron in the middle 1940's (Tr. 14,115, 37,051; GFX 1370J). **[146]**

495. By 1941, Kellogg had fortified its Corn Flakes with vitamin D, and its Pep brand with vitamin D and vitamin B-1 (Tr. 29,715–17). Later in the 1940's, its Raisin Bran was fortified with iron and its Corn Soya had extra protein (Tr. 29,716).

496. Kellogg introduced Special K in 1956, fortified with seven vitamins and enriched with 20% protein (Tr. 29,716, 29,948; CX–GM 564C) and, in 1959, it introduced Concentrate, also vitamin fortified and containing 40% protein (Tr. 29,716). Vitamin D fortification in Kellogg's Corn Flakes was increased to 100% MDR[47] in 1956 (CX–K 457).

497. Product 19, fortified with 100% MDR of eight vitamins and iron, was introduced in 1967. (Tr. 29,663), and Frosted Mini-Wheats was introduced into test-market with fortification to the one-third MDR level in 1969 (Tr. 11,786–87; CX–K 573F). Kellogg fortified its Sugar Smacks with 33% MDR of six vitamins about 1968 (CX–K 7175S, 7352C). Kellogg's 40% Bran Flakes received 100% iron fortification in 1966 (CX–K 487), as did its Raisin Bran by 1969 (CX–K 415, 7177F).

498. When General Foods developed Oat Flakes in 1962, the product consisted of oats, soy, and wheat, and initially rice. However, since the product was called an oat flake, it was fortified to the point of having the protein quality and quantity, the nutritional micronutrients, the vitamins and the minerals of whole oats (Tr. 37,051–52). In 1966, one-quarter of the daily requirement of a series of vitamins and minerals was added to the product and the name was changed to Fortified Oat Flakes (Tr. 13,616–17).

499. After fortifying Oat Flakes, General Foods considered fortifying its entire cereal line (Tr. 37,059). In 1967, Sugar Crisp was fortified to one-third MDR and reintroduced as Super Sugar Crisp (Tr. 37,052).

500. According to complaint counsel, respondents avoided widespread fortification prior to 1971, at which time, pursuant to agreement, they fortified their RTE cereal lines in concert. However, the following fortified RTE cereal products were in the market by 1970:

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[47] "MDR" refers to the minimum daily requirements for certain vitamins and minerals as set by the United States government.

KELLOGG: Kellogg's Corn Flakes, fortified with vitamin D by 1941, increased to 100% MDR, 1956 (Tr. 29,716–17; CX–K 457); *Pep,* fortified with vitamins D and B1 by 1941 (Tr. 29,715–17); *Special K,* fortified [147]with seven vitamins and protein, 1956 (Tr. 29,716, 29,948; CX–GM 564C); *Concentrate,* vitamin fortified and protein enriched, 1958 (Tr. 29,716); *40% Bran Flakes,* fortified with 100% iron, 1966 (CX–K 487); *Product 19,* fortified with 100% MDR of eight vitamins and iron, 1967 (Tr. 29,663); *Sugar Smacks,* fortified with ⅓ MDR of vitamins and iron, 1967 (CX–K 7135S, 7352B, C); *Mini-Wheats* fortified with ⅓ MDR of vitamins and iron, 1969 (Tr. 11,786–87; CX–K 533); *Raisin Bran,* fortified with 100% iron by 1969 (CX–K 415, 7177F).

GENERAL MILLS: *Hi-Pro,* fortified with seven vitamins and iron, 1958 (GMX 180); *Total,* fortified with 100% MDR of eight vitamins, 1961 (GMX 179B); *Corn Total,* fortified with 100% MDR of eight vitamins, 1966 (GMX 180B); *Vital 7,* vitamin fortified, 1967 (Tr. 17,162); *Alive,* fortified with extra Vitamin B2, Niacin and Iron, 1968 (Tr. 16,979; GMX 181B); *Kaboom,* fortified with 100% MDR of eight vitamins and iron, 1969 (CX–K 765E; GMX 174B); *Buc Wheats,* fortified with ⅓ MDR of eight vitamins, as test marketed August 1970 (CX–K 765E; GMX 179B).

GENERAL FOODS: *Bran Flakes,* fortified with iron, 1966 (CX–K 487); *Fortified Oat Flakes,* fortified with six vitamins and minerals, 1967 (Tr. 37,052, 37,059; CX–GF 1406C); *Sugar Crisp,* fortified with ⅓ MDR of vitamins and minerals, 1967 (Tr. 37,052); *Alpha Bits,* vitamin fortified to ⅓ MDR, 1969 (CX–GF 601H); *Honeycomb,* vitamin fortified to ⅓ MDR, 1969 (CX–GF 601H).

QUAKER: *Quisp* and *Quake,* fortified with ⅓ MDR of vitamins and iron, 1968 (Tr. 15,044–45); *King Vitaman,* fortified with 100% MDR of vitamins and iron, 1970 (CX–K 765C).

501. In 1970, vitamin fortified brands accounted for some 17% of industry pound sales, and cereals fortified with iron accounted for another 6% of the market (CX 434). Respondents' fortification efforts prior to 1970 achieved competitive results—for example, the competitive impact of Kellogg's Product 19 on General Mills' Total (CX–K 7176A; CX–GM 567A), the fortification rivalry between Kellogg's Product 19 and Special K and General Foods' Fortified Oat Flakes (CX–GF 34A), and between General Foods' Sugar Crisp and Kellogg's Sugar Smacks (CX–K 595A, 7352B, C, I).

502. This fortification activity prior to 1970 took place not only in the climate of the pronouncements of the Council on Foods and Nutrition of the American Medical Association and the Food and

Nutrition Board of the National Research Council, related above (Finding 493), but also in the face of an adverse position taken by the Food and Drug Administration (FDA).

503. FDA policy adverse to the fortification of RTE cereal products was a major obstacle to RTE cereal fortification. During **[148]**the mid-1960's, the FDA publicly opposed fortifying RTE cereals beyond allowable limits, on the ground that the availability of vitamins to consumers from other sources made cereal fortification unnecessary (Tr. 29,949–50, 37,054–59).

504. In 1962, the FDA commenced rulemaking proceedings concerning regulation of processed food fortification (27 Fed. Reg. 5815 (June 20, 1962)). In 1966, it proposed a rule, Part 80.2 of which would have prohibited the addition to RTE cereals of vitamins and minerals other than niacin, thiamin, riboflavin and iron. Minimum and maximum limits covering the use of these four nutrients would also have been established (31 Fed. Reg. 8525–26 (June 18, 1966)) (KX 101; Tr. 29,718, 37,056). Part 80.2 embodied the prevailing FDA policy that restoration of vitamins to whole-grain levels constituted the maximum appropriate vitamin supplementation (Tr. 37,056). FDA held protracted hearings regarding the proposed regulation (Tr. 29,718; CX–CI 80A).

505. If adopted, the FDA regulation would have precluded the high levels of fortification subsequently adopted by respondents in 1971–1972, and would have required the reformulation of certain established fortified cereals (KX 101; *see, e.g.,* GMX 174 through 181; CX–GF 102K).

506. At the time of the FDA's rule proposal, respondents anticipated serious impact on their fortified cereals (Tr. 29,949). For example, in 1966, General Mills believed that the regulation threatened the future of its fortified Total: "[T]he probability of passage creates a serious potential threat to the brand" (CX–GM 564C). General Mills' 1969–1970 Total marketing plan stated: "Possible future FDA regulations could force elimination or massive reformulation of Total" (CX–GM 567A). Kellogg delayed increasing the iron content of Raisin Bran from 80% to 100% MDR until after it was advised that such action would not cause a government reprimand (CX–K 439B).

507. The effect of the FDA policy was to delay fortification of many cereals until the 1970's (Tr. 13,141, 29,717–19, 35,812, 37,053–55).

508. In addition to the FDA, American Medical Association and National Research Council opposition to fortification of foods and perhaps as a result of such opposition, there was limited consumer

demand for fortified RTE cereals during the 1960's and only limited, temporary success for products that were fortified (CX–GF 102G; CX–K 487; Tr. 15,043–44, 16,980–82). The record fails to indicate that respondents' individual competitive efforts prior to 1970 in the field of product fortificaton were not fully commensurate with the public demand. There is no evidence that indicates that respondents reached agreements concerning, or coordinated, their pre-1970 fortification conduct.

509. Throughout the pre-1970 period and thereafter, respondents individually engaged in extensive research to overcome technical **[149]**problems involved in cereal fortification. There have been many such problems including workable methods of fortification application, uniformity of product, unacceptable taste, odors and appearance, deleterious chemical reactions, maintenance of vitamin potency through the cereal processing procedure, maintenance of proper product moisture levels and shortened shelf life. These problems varied product by product and by the particular nutrient and combination of nutrients involved (Tr. 12,367, 13,004, 13,339–401, 13,670–71, 13,668–69, 14,150, 16,982, 29,280–82, 29,951, 32,911, 32,916–17, 35,808, 36,670–71, 37,002, 37,052–53, 37,062–63; GMX 373).

510. Some of the problems have been very difficult to overcome. For example, General Mills has never been able to add vitamins A and D to Cocoa Puffs or to add minerals other than iron to any cereals because of bad taste problem (Tr. 35,803, 35,813). Considerable expenses were incurred in researching and implementing product fortification (Tr. 16,982, 29,952–53; CX–GF 477).

511. General Foods' research into beneficial product additives was not limited to vitamin and mineral fortification. Starting about the end of 1959, General Foods promoted research on the possible inclusion of phosphates to inhibit dental caries. Much of this was done in conjunction with the Indiana University Foundation, as well as outside specialists and statisticians. Because of what appeared to be questionable research procedures, Indiana University and General Foods agreed to terminate the joint research arrangement in 1972. General Foods continues to perform animal research with phosphates (Tr. 37,110–11).

512. General Foods' unilateral investment of substantial sums in research into the prevention of tooth decay is inconsistent with complaint counsel's allegation that General Foods, in conjunction with other respondents, avoided having one respondent acquire a competitive advantage over the others. Respondents' overall, vigorous competition in the introduction of new products (*infra,* Findings

530–602) is also totally inconsistent with the charge that they conspired in the particular area of fortification.

513. In the late 1960's and early 1970's, there was a dramatic change in the national attitude toward the fortification of cereals. During 1969, the President had convened a White House Conference on Nutrition, which issued a report in December 1969 (GMX 501). That report was to the effect that there were significant nutritional deficiencies in the diets of large segments of the population. It was recommended that the proposed FDA regulations barring the fortification of breakfast cereals not be adopted, because the widespread acceptance and consumption of breakfast cereals made them effective carriers of essential nutrients. It attacked the view that all needed nutrients were obtained from ordinary diets and recommended strong food fortification programs (Tr. 35,811–12; GMX 501Z94–96, Z120–22, Z–253). Consequently, the FDA abandoned its proposed rule to prohibit food fortification (Tr. 29,718, 37,057–58). **[150]**

514. The Conference increased consumer interest in vitamin fortification and provided impetus to the fortification programs of each respondent, which resulted in whole-line fortification in the early 1970's (Tr. 13,140, 29,719–20, 35,057–08, 35,810–11).

515. At the time of the White House Conference, congressional hearings were being held, but there was no resolution of the matter at that time (Tr. 37,058).

516. Subsequently, in July 1970, Mr. Robert B. Choate, a civil engineer, in testimony before a congressional committee, criticized the lack of nutrients in RTE cereals. Mr. Choate's testimony further increased industry and consumer interest in vitamin fortification. His testimony was widely publicized, and the majority of RTE cereal consumers were aware of it (Tr. 37,061–62; CX–GF 3000Z–105).

517. Choate rated RTE cereals by name as to their nutritional value. As a result, certain fortified brands benefited from Choate's highly publicized testimony (Tr. 29,951–52). Sales of four fortified cereals, Fortified Oak Flakes, Total, Special K and Product 19, improved after Choate testified (CX–GF 477C, 1429B; KX 4; CX–GF 340A). Purchase of certain nonfortified cereal brands, Wheaties, Cheerios, Rice Krispies, and Grape Nuts, appeared to decline (CX–GF 1429B; *see* CX–GM 16A, 17A).

518. Kellogg had commenced development of the systems necessary for extending fortification at the one-third MDR level to all of its cereals in the late 1960's, at which time Kellogg had decided to fortify all products (Tr. 29,278–81). Kellogg, at the time of Choate's testimony, had already begun to install the equipment required to

apply increased levels of eight vitamins called for in its expanded fortification effort. This enabled it to begin production of cereals fortified at the new, higher vitamin levels within several months of Choate's testimony (Tr. 29,952-53; *see* CX–K 7187R). Kellogg's decision to fortify its entire line was given additional impetus by the 1969 White House Conference on nutrition (Tr. 29,719–20). The decision had already been made to fully fortify prior to Choate's testimony (Tr. 29,719–20).

519. Kellogg's Sugar Pops, Froot Loops, Apple Jacks, Sugar Frosted Flakes, Cocoa Krispies and Puffa Puffa Rice were fortified by late 1970 or early 1971 (CX–K 7187R). Two of Kellogg's largest selling brands, Corn Flakes and Rice Krispies, were not fortified until 1972; Corn Flakes was not fortified until September of that year (CX–K 7192F, 7193G, 7209E).

520. General Mills decided to fortify all its cereals to the ⅓ MDR level of seven vitamins and iron on September 17, 1970 (Tr. 35,814; GMX 373). It fortified the majority of its cereals from August 1971 to January 1971 (GMX 174 thru 182). Fortification of Cheerios and Wheaties was in August 1971, and General Mills' established presweetened cereals were fortified from October 28, 1971, to January 1972 (GMX 174, 175, 177, 179). **[151]**

521. General Foods' decision to fortify its entire line of cereals preceded Choate's testimony (Tr. 37,052, 37,062). By February 1970, General Foods was prepared to fortify its entire line of cereals (at ⅓ MDR vitamin and 100% MDR iron) subject to "Business Manager approval" (CX–GF 2022E). Choate served to accelerate implementation of General Foods' decision (Tr. 37,062). By late 1970 or early 1971, General Foods had completed its plan for such fortification and set a schedule to fortify its brands through 1971 and 1972 (CX–GF 477). General Foods planned to fortify its cereals in stages—first the presweets by September 1971, and then the remaining cereals by March 1972 (CX–GF 477C). The project was actually completed in 1971 (Tr. 37,059).

522. General Foods, through advertising and other promotional activity, attempted to secure a competitive advantage for its fortified products (CX–GF 340B, 477C). Kellogg recognized that it had been disadvantaged by General Foods having fortified its Raisin Bran before Kellogg did so (CX–K 7198D, E).

523. Kellogg introduced its newly fortified line of cereals in 1971 with an aggressive advertising and promotional campaign (CX–K 765R, S, U, W, Y, Z–2). However, since Kellogg had lagged behind its competition by not fortifying its most popular brand, Corn Flakes,

until September 1972, it lost sales to General Mills' Cheerios and Wheaties and to General Foods' Post Toasties (CX–K 7192F, 7209E).

524. The foregoing recitation of respondents' activities in the area of product fortification reveals that they were fully consistent with individual, competitive responses to stated public policy and consumer interest and demand.

Complaint counsel, however, assert (CPF 8–227 thru 8–233; CRPF 8–264 thru 8–269) that respondents convened meetings of the Executive Committee of the Cereal Institute on July 27, 1970, and August 21, 1970, in order to agree on how to respond to the attacks of Choate and others on the cereal industry for its failure to provide nutritious food, and that respondents there reached agreement on how to fortify their RTE cereals. This agreement is evidenced, according to complaint counsel, by the contemporaneous actions of respondents to fortify to the ⅓ MDR level.

525. The July 27, 1970, meeting of the Executive Committee of the Cereal Institute was called "to consider the impact of the recent testimony of Robert Choate in which he attacked the nutritional value of cereals" and to decide upon "what action if any should be taken by the Institute on behalf of the industry to introduce proof of the nutritional value of cereals before the Subcommittee and otherwise to repair the damage done by the unjustified statements and charges of Mr. Choate" (CX–CI 78B). The only action taken at the meeting, that was evidenced, was that of authorizing the Institute to arrange for a **[152]**leading nutritionist to testify before the Senate subcommittee "as to the nutritional value of breakfast cereals and their place in the American diet" (CX–CI 78B).

526. On August 21, a special meeting of the Board of Directors of the Cereal Institute was held to discuss the testimony by Institute and industry witnesses which had been presented to the Senate subcommittee on August 4, and to discuss further efforts to educate the public on the role RTE cereals played in a nutritional diet (CX–CI 80). It was noted in the minutes of the meeting that Senator Moss of the Senate Subcommittee had suggested that the cereal industry should eliminate differences in the nutritional content of breakfast cereals and make greater progress in educating the public of nutritional facts concerning breakfast cereals; and that Mr. Paxton, the Cereal Institute's legal counsel, had advised that "despite the senator's suggestion, the elimination of product differences might not be an appropriate matter for concerted action" (CX–CI 80A).

527. The record contains no evidence that respondents discussed any plans for action regarding fortification at either of the two Cereal Institute meetings. Representatives of Kellogg and General

Mills who were present at the meetings testified that there were no agreements regarding fortification (Tr. 29,720–21, 35,463, 35,806, 35,815). And the record contains no evidence to overcome this testimony. Nor is there any evidence that the respondents otherwise communicated regarding their fortification activity, or that any respondent had advance knowledge of the fortification plans of the others. General Mills became aware of competitors' fortified products only when they appeared on retail shelves (Tr. 35,814).

528. Not all cereals were fortified to the ⅓ MDR level (Tr. 29,663, 37,095; CX–K 765C). To the extent they were, this is not surprising inasmuch as breakfast is one of the three usual daily meals, and respondents were being responsive to recommendations of the White House Conference regarding fortification levels (GMX 501Z–101, Z–121, Z–197–98, Z–231, Z–232). General Mills was unaware of Kellogg's and General Foods' plans when it set fortification levels (Tr. 35,808, 35,814).

529. Complaint counsel do not challenge the right of respondents to belong to the Cereal Institute. The two meetings of the Institute, relied upon by complaint counsel for their hypothesis of agreement, have not been shown to have been conducted for other than legitimate purposes.[48] There is no basis for an inference that **[153]** fortification activities, which were most reasonable in the light of ongoing events, were in response to an otherwise unproved agreement rather than the ongoing events.

4. *Introduction of New Products*

Complaint counsel assert that there is a barrier to entry into the RTE cereal industry and would place responsibility for the existence of the barrier upon respondents. The cornerstone of the barrier to entry theory, which theory will be considered in the next section, has been termed by complaint counsel "brand proliferation." It is complaint counsel's position that respondent's avoidance of competition by other means led them to turn to brand proliferation, "the introduction of a large number of differentiated, highly advertised trademarked brands" (CPF 1–31, 9–1, 9–3, 9–35; CRPF 9–2, 9–10, 9–11).

530. Complaint counsel and their expert witnesses have conceded that respondent's brand proliferation is vigorously competitive, not predatory and not in itself unlawful (Tr. 22,607, 22,614–15, 22,622,

[48] The Cereal Institute was founded in 1941 for the purpose of advancing public understanding of the nutrition offered by cereal products (Tr. 11,863–72).

22,629, 22,865, 22,906, 23,264, 23,304, 23,678, 27,267; GFX 1166A–B, 1167).

531. Respondents engaged in unrestrained and uncoordinated competition in the introduction of new products. Such competition was intense (Tr. 21,922, 22,056, 22,605–08, 22,905–06, 22,615), and there is no evidence of a conspiracy or intent to deter entry by means of new product introductions (Tr. 22,109, 26,693, 27,028, 28,284, 30,518–23, 30,538).

532. Respondents, therefore, may not be held responsible for the results of this legitimate method of competition unless it was the proximate result of their having otherwise limited their competitive efforts as charged. However, as I have already held, complaint counsel have failed to prove those charges. Further, even if respondents had conspired or otherwise unlawfully coordinated their other competitive efforts, new product introduction would still have remained as a legitimate vehicle of competition. There is no causal relationship shown between the alleged avoidance of other kinds of competition and competition by brand introduction. Not only is there no showing of proximate cause, but, if respondents had conspired to fix prices or had engaged in price leadership-price followership in lieu of overt collusion, competition by introduction of a large number of differentiated products would have been avoided as the antithesis of such coordinated behavior (*see, supra,* findings 192–97).

As found above (Findings 229–31, 238–39, 245–47, 250–51, 323–26), respondents did not want to engage in price wars and the record does not evidence strong price competition among them. This is consistent with Professor Schumpeter's theory that firms in oligopolistically-**[153]**structured industries would tend to pursue competitive strategies which could not easily be matched by their rivals; that price competition, for example, would give way, among other things, to the development of new products, whereby a company could secure an extended competitive advantage (Tr. 38,276). As Dr. Scherer has written, *Industrial Market Structure and Economic Performance* 342 (1st ed. 1970):

> [A]ny fool can match a price cut but an ingenious promotion campaign is hard to counteract.

This may well explain the emphasis by respondents on competition through new product introduction rather than price competition. But respondents may not be held accountable for any results flowing from their individual choice to pursue this lawful means of competition.

The following findings, therefore, are not necessary to my disposi-

tion of the issue of the introduction of new products, but are included for the use of a reviewing authority in the event it might take a different view.

533. Consumers desire variety for breakfast (Tr. 14,421, 14,446, 17,191, 17,398–401, 22,751, 35,367, 35,400, 35,447, 36,372; CX–CI 103Z–64; GFX 1153Z–71). Such a desire is responsible in large measure for the differentiation of RTE cereals (Tr. 22,751). A firm in the RTE cereal industry must introduce new products in order to remain profitable and compete for market share (Tr. 38,520, 38,797–98, 38,830; CX–CI 103Z–5).

534. Kellogg's policy has been to rely primarily on its proven brands, but to build on top of them with new products having good potential (CX–K 397D, 549C, 7358F). It believes that if it has a product with wide appeal, it must introduce it or someone else will; that it is better for Kellogg to continue to expand its products even if it is taking some business away from other Kellogg products than for a competitor to do so (Tr. 13,046–51, 29,954, 29,683–84).

535. "Although Kellogg does not agree that all profitable opportunities in the ready-to-eat cereal market have been exploited, Kellogg is doing its best to continue to exploit those additional opportunities . . ." (KPF 5–155).

536. General Mills stressed new product introduction at increasing levels as a major competitive effort and sought to outdo competitors in this regard (Tr. 17,353–66; CX–GM 38A, 608F, 609M, 610W). It believed it to be imperative to continue to introduce competitive new products (CX–GM 263A). General Mills was concerned at the inroads on its own absolute sales volume and market share that new products of its competitors might make (CX–GM 3D, E). Both General Foods and Kellogg recognized General Mills' policy of stressing new product introduction (CX–GF 4039Z–1; CX–K 553H). **[155]**

537. General Foods also recognized a competitive requirement to introduce new products. As early as the 1950–1952 three-year plan for the Post Cereal Divisions, we find (CX–GF 167Z–10):

> The need for new products which could augment our volume, help carry our overhead, and at least potentially contribute to profits has long been recognized. Since the total cereal business is at best stationary, and since therefore our principal chance to increase our volume is to take business away from competitors, new products are vitally important. It is not easy to increase the share of business done by our older established products.

538. General Foods, from the early 1960's, introduced new products in an attempt to maintain total volume and to make up for declining sales of established General Foods brands. New products

were also viewed as the key to growth (Tr. 14,140, 36,371; CX–GF 4A, 17D, 324A, 602K, 2044D, 4039Z–53).

539. General Foods, in 1967, decided to remain in the RTE cereal industry by placing a high priority on developing new products (CX–GF 4039D, G). In its proposed marketing plan for FY's 1968–1970, we find (CX–GF 4039Z–59):

> The underlying assumption for Post new product strategy is that over the next three to five years continued competitive new product pressures, compiled with a static market will force volume losses on brands currently being marketed. . . .
>
> * * * * * * *
>
> Therefore, Post's new product program will be designed over the next three years to provide new products to hold or slightly grow total Post volume.

540. Changes in American society in the 1950's and 1960's, with resultant changes in consumer demand, contributed in large measure to the introduction of new RTE cereal products. The "baby boom" significantly affected the RTE cereal industry. Since RTE cereals are so convenient, the increase in the number of children offered a great opportunity for producers to develop new products to appear to them (Tr. 29,621–22, 29,786–87; CX–GM 736A). Because of the increased pace of modern living and the increased number of women in the labor force, there was an even greater demand for RTE cereals **[156]**which children could eat without parental assistance (Tr. 29,623–24, 29,787). Other shifts in demand, including the call for nutritious and natural cereals, also impelled respondents to introduce new products (Tr. 26,256, 29,680–84, 29,787).

541. The advent of television enabled respondents to visually impact consumers with the claimed benefits and attributes of new products. This ability to have a direct, nationwide impact on potential consumers facilitated the sale of new products and provided an incentive to respondents to develop new products (Tr. 27,100–01, 29,624, 29,702–07, 29,780–81; CX–GM 736A; CX–GF 4U; CX–K 563D).

542. New products were introduced by each respondent in order to compete against other RTE cereal manufacturers. Kellogg, for example, introduced a new product, Puffa Puffa Rice, so that it would not be preempted by a Quaker product, Tin Tin, that was being successfully marketed in Canada (Tr. 12,380–83, 12,891–92, 12,965–66, 22,131, 23,081–82, 30,706–07; CX–K 7163A). Kellogg introduced Product 19 to compete with General Mills' Total (Tr. 12,396–98, 12,839–40; CX–K 7353H), OK's to compete with General Mills' Cheerios, Froot Loops to compete with General Mills' Trix, and

Cocoa Krispies to compete with General Mills' Cocoa Puffs (Tr. 11,907–12, 12,684–94, 12,875–76, 13,545–46, 29,661–62; CX–K 502C). And Kellogg introduced its granola in response to entry into that segment by competitors (Tr. 13,087–88), as did General Mills (Tr. 17,802).

543. General Foods, during the early to mid 1960's, spent several million dollars to introduce a line of corn flakes with fruit (GFX 416D). It considered this to be a very exciting opportunity to secure a real competitive advantage, to the point of overtaking Kellogg (Tr. 36,380–81; GFX 1297). Even with respect to new products that were essentially variations of existing ones, General Foods sought to capture a small but profitable share of the total RTE cereal business (CX–GF 6T).

544. While respondents' new product introductions, to some extent, expanded the RTE cereal market by appealing to additional consumers and inducing consumers to eat more cereal products (CPF 9–286; Tr. 7573, 11,432, 13,010, 15,223–26, 17,681–82, 29,678–79, 29,780, 35,410, 35,417, 35,421–22; CX–K 560C; CX–GF 4039Z–53), they did have a competitive impact on respondents' other RTE cereal products, either by a reduction of sales or by adversely affecting sales growth (Tr. 7551, 7559–70, 8824–25, 14,198–99, 14,088–89, 14,220–27, 14,966, 15,222, 15,754–55; GMX 71, 73, 97, CX–K 397C; CX–GF 1455I).

545. Kellogg did not believe that every new product had to be profitable as long as the whole line showed a profit (CX–K 565I, L). Kellogg introduced new products when necessary to stop competitors from making inroads into Kellogg's business (Tr. 11,316; CX–K 686B). Kellogg believed that the introduction of two products at the same time reduced product trial (Tr. 12,965–70; CX–K 604A–C). Kellogg increased its advertising on Froot Loops while General Mills was **[157]**seeking to introduce Lucky Charms (Tr. 22,133–34). It also increased its advertising of Special K when General Foods introduced Fortified Oat Flakes (CX–GF 34).

546. General Mills introduced products with relatively low life potential in order to boost its overall line share of the market and counter a potential loss of customers to competitors' new products (CX–GM 3D, E). It introduced new brands as defensive moves to help prevent competitors' new brands from taking hold (CX–GM 2A, C, 262B, 276, 2171C, 2176F). It sought to keep its own products on the shelves, even though it recognized they had no future, until it could introduce still more of its own products to replace them (CX–GM 285). General Mills increased its advertising, use of coupons, and use

of samples with Total during Kellogg's introduction of Product 19 (Tr. 17,620–29, 23,075; CX–GM 21, 123A, B, 570N, Z–15, 720A).

547. General Foods introduces a new product only when it is believed to meet a perceived consumer demand and a reasonable profit can be anticipated (Tr. 36,372). It has never introduced a product that it did not think would succeed (Tr. 13,666, 36,435), although it did not expect its brand introductions in the 1960's to be as long lived as older brands (CX–GF 4039Z–59). It has introduced line extensions of particular cereals (*e.g.*, flavor variations) to induce consumers to stay with its products rather than try RTE cereals of competitors (Tr. 17,481–82; CX–GF 1455C, 2029B).

548. Kellogg believed that the growth of sales in an area meant that there might be an opportunity for a new brand in that area. Its general practice, therefore, was to identify areas of opportunity for new brands by looking at the sales growth of particular brands in particular market areas (Tr. 12,832–41).[49]

549. Kellogg has many sources for its new product ideas. These include brainstorming sessions involving Kellogg employees and members of its advertising agency (Tr. 29,977); outside consulting firms (Tr. 30,034); and observations of the marketplace (Tr. 16,534–35, 16,871–73, 29,795, 37,014–15, 37,030; GFX 1299). For example, Kellogg continually monitors the products of its competitors to determine whether an opportunity for an improved product exists (Tr. 12,269, 12,404, 29,801–02). Kellogg's General Sales Manager urged all Kellogg product marketing managers to watch for the product innovations of small manufacturers. He advised marketing managers to **[158]**"keep especially alert for successful locally marketed products that could be duplicated and mass-produced for national marketing—especially those compatible with our existing product lines" (CX–K 676B). Once such an idea was obtained, Kellogg, because of its technological capabilities, could improve on it and make the Kellogg product available nationwide (Tr. 12,184, 29,609–11).

550. Almost every department at Kellogg has some responsibility for the development of a new product, including the research and development group, the marketing research group, the process development, packaging development and quality control groups, the administrative group, the controllers and the purchasing people (Tr. 29,774, 37,032–33). The product development coordinator, whose position was established in 1958, is responsible for facilitating a

[49] For example, the growth of General Mills' Total led Kellogg to develop Product 19 (Tr. 29,795–96); Froot Loops were introduced to take advantage of an opportunity to appeal to users of the first fruit-flavored presweet, Trix, another General Mills product (Tr. 12,875–76).

product's orderly progression through its developmental stages into test market and general distribition (Tr. 29,773–75).

551. Kellogg made extensive use of marketing research tests to determine consumer reaction to various characteristics of products. This included blind paired comparison tests to determine what consumers deemed to be significant differences between products (Tr. 11,638–39, 12,957–62, 29,846). This was to prevent the offering of a me-too product (a product without a significant difference), which is recognized to be a likely failure in the marketplace (Tr. 9184–88, 12,965, 14,516–25, 14,584–86, 14,966–67, 15,228, 15,847, 15,851–53, 15,952, 17,453, 17,627–31, 17,634, 17,650, 22,722, 26,549; CX–K 396B).

552. Thus, the development of a new Kellogg product calls for expensive testing, including consumer panel tests, concept testing, blind paired comparison tests, in-home tests, central location tests, test marketing, as well as taste testings which expert respondent employees are continuously engaged in (Tr. 15,981–16,046, 29,800, 29,843–46, 32,970–82, 37,039–44).

553. Although each new product may vary as to the steps in development and problems encountered, Product 19 affords some perspective of what can be involved in the development of a new product (Tr. 29,794). Kellogg observed the success of General Mills' Total, as well as vitamin and mineral supplements like One-A-Day vitamin pills and Geritol. Kellogg analyzed and tested Total and decided that that product indicated an area of opportunity for Kellogg (Tr. 29,795–96).

554. Kellogg employees from all sections of the company then gathered to discuss the characteristics, technological needs, and competitive potential of the desired product. Upon establishment of a product objective, research personnel were put to work. They requisitioned the use of a pilot plant and laboratories for the manufacture of a product prototype. Once work on the product had begun, the group met constantly to review the prototype and its progressive transformations (Tr. 29,796–99). **[159]**

555. After the manufacture of what was believed to be a successful prototype, Kellogg employees conducted internal taste tests in which they compared the Kellogg product with Total. Generally, after a prototype has elicited positive responses from an internal taste panel, Kellogg turns it over to members of the process development department, the packaging department and the research department for further improvements. Meanwhile, Kellogg continues testing the product in order to insure consumer acceptance. If the results of these tests are encouraging, the company hires professional testing organizations to conduct panel tests among

consumers. Because the results of the new product's consumer tests were positive, Kellogg decided to go ahead with it, Product 19 (Tr. 29,800, 29,835–37, 29,846–48, 29,887–88).

556. Once Kellogg decided to market Product 19, its production required technology that had never been used under manufacturing conditions. In order to test this technology, Kellogg established a manufacturing pilot plant with actual-sized equipment, but on a smaller scale. This plant cost $550,000.00. Product 19 was test marketed in 1966 throughout the Pacific West Coast, in Florida and in Texas. Although the product lost money during test marketing, Kellogg had expected the loss and considered it an investment (Tr. 29,848–52, 37,246–47; CX–K 7368B).

557. After being test marketed for 18 months, Product 19 proved to be a success. Kellogg then established a full-scale production facility which cost approximately $4 million. This investment did not return any profits until Product 19's third year of production. It took seven years to recoup the product's early operating losses (Tr. 29,854–55, 29,858).

558. New product ideas at General Mills are generated from several sources, such as research and development, marketing research and interviews with consumers. New product ideas are first concept tested with consumers. A concept test is based on a pictorial representation and a written or oral description of the proposed new product. New product ideas which are well received by consumers are then guidance tested with consumers. Guidance testing is a sequence of tests in which groups of 50 to 75 consumers taste the product and respond to written questions concerning its attributes. The product is modified after testing in response to consumer input. A product that is rejected by consumers is not pursued. Products that survive guidance testing are then put through large scale evaluative testing. Here, the product is placed with a representative sample of 300 to 600 consumers to determine its level of satisfaction (Tr. 15,966–71, 15,978–79, 15,983–97, 15,999).

559. General Foods periodically analyzed the RTE cereal market by looking at segments of people and brands to try to find an unoccupied space or gap in the market. Brands were arrayed in relation to each other based on how people perceived them, and how they were rated with respect to particular attributes. People indicated what brand they would substitute if they could not find a **[160]**certain product. New product ideas were suggested by the study reports (Tr. 14,192–93, 14,407–16).

560. General Foods' market research department regularly conducted product testing, advertising research, information-gathering

on marketplace performance, test marketing research, attitude studies, packaging tests and other types of research (Tr. 14,344; *see, e.g.,* GFX 584).

561. The market research department also collected information about the types of people who were buying different products—"consumer profiles." Studies to learn what was happening in particular markets were also conducted (Tr. 14,345–46).

562. General Foods' and competitors' new products and their performance were evaluated (Tr. 14,346; GFX 552). Market Research conducted product quality tests in which consumers were asked to compare General Foods brands with other cereal products (Tr. 14,472–74; GFX 547, 549).

563. Information was secured from syndicated types of services, such as A.C. Nielsen Company, SAMI and MRCA and from market research organizations (*see, e.g.,* Tr. 14,349; GFX 289, 537, 547; CX–GF 1348).

564. General Foods' market research department thus was able to obtain information concerning the incidence of cereal purchases, the demography of the consumer groupings and the frequency of purchases (Tr. 14,365).

565. An effort was then made to come up with products that answered people's wants so identified and measured (Tr. 14,370).

566. Market research would track a new product's performance in terms of volume, share of market and consumer feedback. Such tracking would aid in the development of new product ideas (Tr. 14,368).

567. Consumer testing continued long after the introduction of a brand. General Foods tried to determine how its products were performing in the marketplace and to evaluate new opportunities (*see, e.g.,* GFX 535, 552).

568. New product ideas came from many sources—personal experience, marketing sources, marketplace sources, but primarily from technical sources (Tr. 37,015). Some ideas were generated in brainstorming sessions (*see, e.g.,* GFX 1299).

569. Following a brainstorming session, representatives from technical research, marketing research and marketing would meet to select those ideas which appeared to have merit (Tr. 37,032). **[161]**

570. These ideas would then be presented to potential consumers in an "omnibus test," for group discussion and evaluation. This is also known as "concept testing" (Tr. 14,417, 37,035, 37,037).

571. After omnibus testing, highly regarded product concepts would be considered for feasibility by technical personnel who would

develop prototype products reflecting particular ideas (Tr. 37,037, 37,223).

572. A prototype would be exposed to the consumer through market research. Research and development personnel would consider feedback and modify the product accordingly (Tr. 13,412).

573. Further consumer testing would be conducted, exposing prototype products to hundreds or even thousands of families for their reactions (Tr. 37,040).

574. If the product still looked promising, it would be test marketed to indicate what might be expected on a national scale (Tr. 36,440, 37,043).

575. If the product performed well in test market—if it appeared that its potential volume was sufficient to constitute a viable business—it would be introduced nationally. Not all products that were test marketed went into national distribution (Tr. 37,043–44).

576. Performance of a product in national distribution usually lagged behind performance in the test market. If a product failed to meet the goals set for it, it was withdrawn (Tr. 37,044–45).

577. Each product concept was evaluated several times as it was developed to determine whether it justified additional investment. Many concepts would be discarded; others would move forward toward the marketplace (Tr. 36,375–76).

578. General Foods had a New Product Committee, composed of senior managers in the RTE cereal business, to evaluate ideas and to decide whether they justified further investment (Tr. 36,375).

579. Utilization of excess capacity was one of the considerations in evaluating new product development opportunities (Tr. 13,481; GFX 423C).

580. Several of General Foods' new products were offshoots of products made by the Jersey Cereal Company, the small RTE cereal producer that General Foods had acquired (CX–GF 167Z–11).

581. In 1950, 26 brands were in distribution beyond test market. During the next 23 years, the largest six firms introduced 84 brands beyond test market, of which respondents accounted for 60, and withdrew 30 of the 84 introduced. Thus, the number of RTE cereal brands in the market increased from 26 in 1950 to 79 in 1973 **[162]** (Tr. 22,024, 22,029–31; CX 405). Broken down into five year periods, we find the following:

	Brands Introduced Beyond Test Market
1950–55	8
1956–60	15
1961–65	22
1966–70	19
1971–73	20

(CX 407)

582. Because of the influx of new brands, established brands lost market share. The top eight brands accounted for 47.3% of the market in 1964, a drop from 56.9% in 1954 (CX–PG 6B, C). Corn flakes, which accounted for 33% of total RTE cereal sales in 1940, had only a 10.8% share in 1972 (CX–K 7054A, 7148C, 7209D). From 1950 through April 1970, average market share per RTE cereal brand declined from about 4% to about 1.3%, and the average pounds sold per RTE cereal brand declined from around 22 to 18 million pounds. This was despite a substantial growth in total sales (Tr. 22,030–31; CX 409A).

583. RTE cereal pound sales increased by 78% between 1955 and 1972. Products introduced prior to 1955 accounted for only slightly more than 10% of this increase, while products introduced after 1954 accounted for almost 90%. By 1971, about 36.9% of RTE cereal sales consisted of products introduced in the prior 16 years (GMX 564). Respondents' products that existed beyond test market distribution prior to 1955 increased in aggregate pound sales by 107,125,000 from 1955 through 1970 (GMX 564E–F, I).

584. The parties differed in the degree of product introduction activity during the period. Whereas Kellogg was introducing products throughout the 1950's, General Mills increased its introductions in the mid-1950's, and both General Foods and Quaker increased their introductions in the late 1950's or early 1960's. After General Foods introduced Krinkles and Corn-Fetti in 1950 and 1951, it introduced only one more new RTE cereal product before 1959 (GFX 1370H).

585. Between 1950 and April 1972, Kellogg introduced 24 brands into test market or beyond (CX–K 1067); General Mills introduced 34 (CX–GM 2049, 2111); and General Foods introduced 21 (CX–GF 556, 1869O).

586. Following General Foods' decision to emphasize its new product activities in FY 1962 (CX–GF 4039Z–17), it introduced nine **[163]**new RTE cereal products in the next five years (GFX 1370H–I). Quaker did not introduce a new RTE cereal product until 1961.

Kellogg introduced products at a fairly constant level throughout the complaint period, with slightly more activity in 1959 (CX 409B, E).

587. The respondents' success with new products differed. During the complaint period, Kellogg introduced nationally 16 new RTE cereal products. All but three found widespread consumer acceptance and were still on the market at the close of that period (Tr. 29,600–01; CX–K 1067, 7173; CX 434). The other respondents and Quaker all had varied success, with General Foods being the least successful (Tr. 27,009, 27,434, 38,331–32; CX–GF 4039Z–4). General Foods marketed fewer brands of RTE cereal in 1973 (15) than it did in 1964 (17) (GFX 1370).

588. The firms have also had differing success with respect to their already established products. Kellogg's older products have had a good deal of durability. Their sales increased by about 25% since 1958. Sales of General Mills' older products were flat; General Foods' sales of older products declined; and Quaker's sales of older products declined to a little more than half of their 1958 levels (Tr. 38,335–36; GMX 565).

589. Based on market share, the cereal industry became a business of relatively small brands (CX–GF 17A, D, 601Z–5, 602B; CX–K 7342C; CX–GM 2178D). An analysis of the peak market shares achieved by RTE cereal brands introduced from 1950 through 1972 shows that only seven of the 84 introductions had market shares exceeding 2% (CX 434):

BRANDS	YEAR OF INTRO.	PEAK SHARE AND YEAR
Kellogg's Sugar Frosted Flakes	1953	6.3% 1971
Kellogg's Special K	1956	4.1% 1970 & 1971
GF's Alpha Bits	1957	2.7% 1959
GM's Total	1961	2.6% 1967
Quaker's Cap'n Crunch	1965	2.4% 1965
Quaker's Life	1961	2.0% 1966 through 69
GM's Jets	1954	2.1% 1955

Of those seven, only Sugar Frosted Flakes, launched in 1953, achieved a 5% market share or better; only one acheived 4% or better; and the remaining five achieved between 2% and 3% at their peaks. No brand introduced after 1956 and before 1972 achieved 3% or more of the market. Respondents generally considered a new brand a success if it could sustain a market share in the 1% to 1.5% range (Tr. 11,723–26, 15,964, 17,746; CX 434J; CX–GM 2A, 179E, 276A, 591F, 603B, 700B, 2198B; CX–GF 20A–C, 30A, B, 470H, I, K, 1372F, H, 1389E, 2018A, C; CX–K 742A, 995). **[164]**

590. However, as indicated above, not all new product attempts

were successful. For example, from 1968 through 1971, six new products were introduced in the presweet segment of the RTE cereal market. Of these, at least five were definite failures (CX–GF 4010I, Z–39, Z–40).

591. As Quaker analyzed the 1958–1969 period (CX–Q 177H):

> Since 1958, 76 brands of RTE cereal have been introduced into either test market or national distribution. Of these, only 54% are still on the market. Of the 36 RTE cereal brands on the market before 1958, 34 are still on the market.
>
> The failure rate for new brands is even higher than indicated by these data since a considerable number of brands still on the market do not have a large enough share to qualify them as real successes. By dividing the study period into halves it appears that the number of introductions and the proportion of failures increased in the more recent years.

592. From 10 failures of 25 introductions in the 1958–1963 period, the failure rate increased to 35 of 51 introductions in the 1964–1969 period (CX–Q 177M). Altogether, 50% of the RTE cereal brands introduced beyond test market between 1950 and 1972 failed (Tr. 26,406, 26,416–17, 26,758–59; CX–GF 4010I, Z–39, Z–40; CX–Q 177H, M; CX–K 547B; CX 435).

593. Of 26 brands introduced prior to 1950 that were in the market in 1950, 23 were still available at the end of 1972. Of nine brands introduced in the five year period 1950–1955, eight were still available at the end of 1972. Comparable figures for subsequent five year periods are: 1956–1960, 10 of 21 still available; 1961–1965, 12 of 37 still available; 1966–1970, 15 of 42 still available (CX 435). These figures which show the number of brands that were withdrawn after introduction, do not reflect the numerous and costly efforts which did not culminate in products worth introducing, *e.g.,* the cavity preventive RTE cereal effort of General Foods (*supra,* Finding 511).

594. General Foods, in particular, experienced difficulty during the 1960's in its introduction of new brands of cereal and was repeatedly unsuccessful (GFX 1370). It had costly failures in its attempts to develop and introduce cereals with freeze-dried fruits (Tr. 37,046–47).

595. The fixed costs necessary to launch a new individual brand include those of research and development of the brand, market research, production equipment and plant and introductory advertising (Tr. 21,964–65, 21,969–70). **[165]**

596. The fixed costs are significant. The major RTE cereal producers spend on average about $180,000 to research and develop

and test consumer acceptance of each brand they launch (Tr. 21,969, 26,408; CX–CI 103Z–47; GFX 1153Z-47; CX-NC 500 at p. 34).[50] The major RTE cereal producers also spend substantial amounts for new plant and production equipment for many of their new brands (Tr. 21,970). Kellogg spent some $4 million to $6 million for new equipment for Product 19 (Tr. 13,203). General Mills planned expenditures of $1.1 million and $1.8 million, respectively, on new equipment for a new health and a new puff cereal (CX-GM 607E). The Danville plant of Quaker, used initially for King Vitamin, cost more than $6 million.

597. The most significant fixed cost of launching a new RTE cereal is introductory advertising (Tr. 21,969-70).[51] Newly introduced brands require disproportionately heavy advertising to achieve market penetration (Tr. 12,809; *see* CX 508A).

598. Substantial introductory advertising expenditures are necessary in order to persuade enough consumers to try new brands (Tr. 12,466–69, 14,435–39, 15,038, 15,771, 15,777–80, 17,301–03; CX–GF 4010Z–42, 4039Z–56; CX–GM 2180C). Unless it intensively advertises a new brand, an RTE cereal producer cannot get many retailers to place the new brand on their shelves. Retailers will not place a new RTE cereal brand on their shelves unless the manufacturer provides or promises to provide sufficient introductory advertising to "pre-sell" the new brand to consumers (Tr. 8919, 9185, 9348–50, 12,722–24). The high advertising level of the many RTE cereal brands already in the market (the high "noise level") requires high introductory advertising expenditures for new RTE cereals (Tr. 13,097, 14,437–38, 15,038, 15,243–44; CX–GM 557H). Kellogg's Marketing Director has stated:

> It is not unusual for a new product introduction to involve an *initial* outlay for advertising and promotion money that far exceeds the total dollar volume of sales for the first year's introduction. Unless the product succeeds in an *unusual* way—it may become virtually impossible to *ever* recover **[166]**the cost of introducing the new product (CX–K 552G) (emphasis in original).

599. By late 1961 or early 1962, General Foods concluded that introductory advertising expenditures of around $3.5 million were necessary to launch a new brand expected to achieve a 1% market share (CX–GF 17A, D). General Mills stated that the heavy introductory advertising it planned for Smiles ($4.1 million) was essential for success (CX–GM 603E, H, W). The respondents and Quaker spend

[50] General Foods spent between $150,000 and $300,000 on research and development for Alpha Bits during its first three years (Tr. 13,436, 13,635–37).

[51] Advertising during the first 12 months a product is placed in national distribution is considered introductory advertising.

substantial sums on introductory advertising for each brand they introduce. Between 1956 and 1972, they spent on average some $3.2 million per new brand (Tr. 26,399–404; CX 206, 508; CX–Q 177Z–20).

600. Not only are the fixed costs of developing and introducing a new product very high, but there is an extended leadtime in going from the drawing board to national distribution and in reaching a break-even point. Dr. Schmalensee, complaint counsel's economic expert, agreed that it takes approximately four years to get a new product off the drawing board and into national distribution and another three years to achieve a break-even point on the product (Tr. 23,413–14).

601. General Mills' development time for Mr. Wonderful's Surprize and Golden Grahams, products that required new technology, was in excess of 10 years (Tr. 32,990). For products developed primarily on existing technology, General Mills' development time averaged from five to six years (Tr. 17,237, 32,989). General Mills began experimental work on Buc Wheats in 1964, but did not introduce the product Buc Wheats until 1971 (Tr. 32,914, 32,989).

602. The foregoing demonstrates that respondents engaged very heavily in new product competition; that this method of competition was expensive and risky and that there was a long period of time before even a successful new product venture would pay off. It has also been demonstrated that, as a result of respondents' new product competition, individual cereal brands on average accounted for smaller shares of the market and lower poundage of sales.

V. IMPEDIMENTS TO NEW ENTRY INTO THE RTE CEREAL INDUSTRY

A. *Brand Proliferation*

1. *Complaint Counsel's Theory*

Complaint counsel (CPF 9–1 thru 9–338; CRPF 9–1 thru 9–112) would place responsibility upon respondents for the lack of new entry into **[167]**the RTE cereal industry. The following is a summary of complaint counsel's theory of the existence of a barrier to entry and respondents' responsibility therefor.

The RTE cereal industry has enjoyed supracompetitive profits (an issue which will be dealt with later in this initial decision) and was growing rapidly. This should have attracted new entry into the industry. The absence of such entry indicates the existence of a barrier to entry. Respondents' brand proliferation conduct raised effective barriers to the entry of new RTE cereal producers and provides the complete answer to this absence of entry. While brand

proliferation is not in itself unlawful, respondents must be held responsible for its deterrent effects upon entry, since respondents turned to this method of competition as a result of their mutual avoidance of other means of competition.

As I have already found (*supra,* Findings 529–31), brand proliferation in this case is nothing more than the introduction of new brands as a legitimate means of competition and did not result from any other activities of respondents. Thus, respondents cannot be held legally responsible for the impact upon potential new entrants of their introduction of new products. However, for purposes of providing complete findings, I shall continue with complaint counsel's theory of respondents' brand proliferation as the sole barrier to entry into the RTE cereal industry.

The proliferation is said to be of highly-differentiated, intensively advertised, trademarked, new RTE cereal brands. The brands actually differed to varying degrees or, by reason of advertising, the consuming public was led to believe they differed. In this manner, competition among RTE cereal brands was "localized"—the first of three basic conditions under which brand proliferation will cause a barrier to entry.

When competition is not localized, a change in price, advertising or promotion of one brand would equally affect all other brands, and industry-wide reaction could be anticipated. The introduction of a new brand would similarly affect all other brands in the industry. A potential entrant would look to the market as a whole for its source of sales and would anticipate being able to take comparable percentages of sales from all existing brands. Any reaction to the new entry by existing competitors would impact all brands in the market.

On the other hand, when competition is localized, a change in price, advertising or promotion of one brand would affect primarily the other products in the segment in which it is located, and reaction would be anticipated only from the other brands in the segment. The introduction of a new brand would affect significantly only the brands in the segment into which the new brand had been introduced. The potential entrant could look only to the segment **[168]**into which it was considering entry for its source of sales. Existing competitors would react only in the segment involved without impacting other brands in the industry. In sum, the new entrant would have a more limited area from which it might secure sales and it would anticipate more direct competitive reaction from the existing brands in the segment it had entered.

The second basic condition, under which complaint counsel assert

that respondents' brand proliferation has created a barrier to entry, is termed "brand immobility." This means that the attributes of existing brands are so firmly established in the minds of consumers that the brands connot be repositioned to appeal to those who want different attributes. Consequently, when a new brand is entered into a segment, existing brands cannot avoid competition by changing their appeal but must meet the competition of the new brand head on. A potential entrant, therefore, would anticipate this head-on competition from existing brands in the segment considered for entry and so might be deterred from entry.

The third basic condition of complaint counsel's assertion that respondents' brand proliferation has created a barrier to entry is the existence of substantial fixed costs associated with the development and introduction of a new product. These are production, marketing and distribution costs which do not vary directly in proportion with the amount of the item produced.

Respondents are said to have so crowded the market with their products that the introduction of additional, profitable brands by new entrants has been foreclosed.

As the demand for cereals grew, opportunities for new brands did occur. Except for the granola or natural segment of the market, these opportunities or "holes" in the market were filled by the six existing major producers. This is because the existing majors were already operating at an overall efficient scale, so that it was profitable to add an additional product even though the volume of that product alone would not cost justify an outsider entering the RTE cereal industry. An outsider would need several simultaneous successful product entries of the size that can be anticipated in this industry before it could operate at minimum efficient scale and so not be at a cost disadvantage to respondents.

This would be most unlikely since it is difficult to develop successful brands; and by the time an outsider could be ready with several brands, an existing firm could fill any particular hole or opportunity that might exist.

In sum, complaint counsel assert that there is a product efficiency of scale equal to about 1% of the market, whereas firm efficiency of scale is not reached until sales of 3.5% to 5% of the market are achieved. Respondents, all of whom are already operating **[169]**at or above firm efficiency of scale, can introduce a new product whenever a 1% opportunity appears, whereas an outsider cannot. The outsider is faced with the insurmountable task of finding simultaneously three or more opportunities in order to enter the market at

minimum firm economy of scale so as not to be at a cost disadvantage to respondents.

Complaint counsel assert that an outsider would have to find larger individual holes or opportunities than respondents since respondents do not react to each other in a competitive fashion, whereas they would react very strongly to an outsider's entrance in a particular, limited segment.

The requirement to achieve entry by multiple brands is also said to have deterred entry since the entrant would have to expend large capital costs on each of the several brands to be introduced. Complaint counsel assert (CP 9–29):

> The conclusion that respondents' brand proliferation practices have increased a potential entrant's capital costs is based on the previous analysis demonstrating that a potential entrant can no longer expect to attain entry at efficient operating scale with a single brand. The necessity of a multi-brand strategy means that the entrant must fund several research and development efforts, several introductory advertising programs, and possibly several production lines. The record shows that it is much more expensive to develop and introduce five brands whose total sales will fall in the range of from 3.5% to 5% of the market, than it is to develop and introduce a single brand to achieve the same market share. The additional costs of entry via a multi-brand strategy are so great that many smaller firms simply cannot raise the necessary capital. The magnitude of the required capital does not prevent entry by the largest firms, but it does result in their acting more cautiously. If the cost of entry were significantly lower, the attractiveness of the industry would result in more frequent gambles by many firms. But as the costs grow, fewer gambles are taken and firms are likely to exercise such great caution that by the time they have decided to enter, their original brand ideas may have been preempted by one or more brand introductions by respondents. [170]

2. *Localization*[52]

603. Localization or segmentation of brands is the first of the three necessary conditions under which, according to complaint counsel, brand proliferation will cause a barrier to entry. As I have previously found (Findings 59–150), there are segments or categories of cereals within which brands compete more strongly with each other than with other brands because of their similar attributes, and there are some cereals that are so similar that they compete with each other on a one-to-one basis. The record, however, does not permit an exact delineation of the segments and the degrees to

[52] Consumers' desires for variety in breakfast are responsible in large measure for the differentiation of RTE cereals (*supra*, Finding 532). Respondents, for example, may be said to have reacted to children's desires for presweetened and flavored cereals, to many consumers' desires for natural cereals and to many other consumers' desires for fortified cereals. Respondents, therefore, may not be held responsible for localization of this nature. Localization, to the extent it has come about by what complaint counsel term "brand proliferation" is the result of competition by means of introducing new products to appeal to the varying desires of different categories of consumers.

which competition among cereals is confined to those cereals in particular segments. The necessary corollary to this description of localization, as shown to exist in the RTE cereal industry, is that some cereals have a broader appeal than the particular segment or category in which they fall so that they compete to varying degrees with cereals outside of their category.

604. For example, adult products, such as Total, Special K, Product 19, All Bran, 100% Bran and 40% Bran Flakes, not only compete with each other, but also compete strongly with all-family products, such as Cheerios, Rice Krispies, and Corn Flakes. And children's products, which are essentially the presweets, not only compete with each other but compete strongly with the all-family products (Tr. 35,367–70; GMX 194, 195, 546A, 547A–B, 548A–B, 549A). While some presweets compete more directly against other presweets, all 30 or so presweets compete to some degree with each other (CPF 9–172; CX–GF 4K, 1410A, 1439, 3000Z–95; Tr. 22,778–81). Grape Nuts competes with all RTE cereals for its share (CX–GF 40), while Post Raisin Bran competes strongly with General Foods' presweetened cereals (GFX 1210Z–5).

605. Twenty-one other brands each accounted for over 1% of the RTE cereal consumption of the two-member families that purchased **[171]**Cheerios in 1969–1970. For 1975–1976, 25 other brands each accounted for more than 1% of their consumption (GMX 518A–B). Two-member families consuming Kellogg's Corn Flakes had more than 1% of their consumption accounted for by each of 20 other brands in 1969–1970 and by each of 23 other brands in 1975–1976 (GMX 520A–B).

606. Many consumers of RTE cereals are interested in many product attributes such as puffing, flaking, specific grains, shapes, textures, flavors and degrees of sweetness. The number of directly competing brands is determined by the number of attributes relevant to each consumer's purchasing decisions. The number of direct brand competitors increases as the number of attributes relevant to particular consumers increases (CPF 9–185, 9–186, 9–188; Tr. 21,953–54, 22,078–80, 22,771–78, 26,253–54).

607. It is uncontested that RTE cereal products compete on the basis of varying numbers of in-common characteristics that differ in importance, but that no analysis was made to quantify the numbers of direct competitors as a result of these in-common characteristics (Tr. 22,753–54, 22,777, 22,794, 23,892–93).

Inasmuch as localization is a necessary predicate to complaint counsel's barrier to entry by proliferation theory, the question arises whether localization exists to the degree required. As an abstract

theory, it is logical to assume that a new product's success would be limited by the size of the area or segment within which it is to compete. However, to the extent that it may draw customers from outside of its primary segment, its success potential becomes less limited.

608. While the extent to which localizaton prevails in the RTE cereal industry is an unknown, it exists to a sufficient degree to have the type of impact theorized by complaint counsel.[53] Respondents believed that the effect of increasing the number of brands on the market was to increase segmentation (CX–GF 17A, D), fractionalization (CX–K 7342C; CX–GM 2178D), or fragmentation (CX–GM 601Z–5). "The cereal industry has become a business of small brands." Kellogg believed that "a lot of products on the market in 1970 will account for *less than one percent,*" as a result of the continued introduction of new brands. This would result in fewer brands with large market shares (*i.e.,* 3–5%) (emphasis in original) (CX–K 565J). **[172]**

3. *Brand Immobility*

609. Brand immobility is the second of the three conditions under which complaint counsel contend that respondents' brand proliferation has caused a barrier to entry. While I would not expect that a manufacturer of an existing product would, even if it could, reposition a product to accommodate a new entrant,[54] the condition of brand immobility has been established on the record.

610. It is difficult to reposition a product from an idea or concept that people have gained. It may be hard to get people to accept the product's new position if they have associated the product over time in its former position. There is a good deal of risk and expense involved in trying to change people's established concept of a product (Tr. 14,212–13, 14,466–68). General Mills has learned that when you try to make radical changes, you sometimes lose the entire market. It doesn't make sense to reposition an RTE cereal product after it has gone national (Tr. 15,762–63, 17,707–11; CX–GM 2476F–H).

611. Attempts at repositioning have failed. Kix was originally an all-family cereal. It had always had some consumption by children. As Kix's sales declined, General Mills attempted to move the brand more toward children. General Mills changed the package, used

[53] Since localization is an element in evaluating crowding, the comments at the end of my findings on crowding (*infra,* Finding 621) apply equally here.

[54] With the large number of products in the market catering to all nature of consumer wants, there would be no point to the manufacturer of a successful existing product to pick up and run from a new entrant and attempt to compete in a different area. There is no evidence that an existing brand has ever been repositioned to accommodate a new brand.

Kix's first in-pack premium and urged retailers to place Kix in a presweet shelf position. These efforts at repositioning were not successful. The result was a lowering of Kix sales. Former adult consumers ceased buying it, while it failed to win children's support (Tr. 17,316–18, 17,323, 17,662–65; CX–GM 124B, 2173). General Mills attempted to reposition Trix by changing its shape, texture, sweetness, package, and name. The attempt destroyed the identity of the product and Trix sales decreased significantly (Tr. 17,708–11; CX–GM 2476F–H). An attempt by Kellogg to reposition Cocoa Krispies towards younger consumers was unsuccessful (Tr. 12,887–88).

612. When introduced, Clackers' advertising and its premium offer positioned it as a child cereal. Because of its low repeat sales, General Mills considered repositioning the product. However, **[173]** General Mills believed it would be very difficult to persuade adults to purchase the product since the original image had been established so strongly. Instead, the product was withdrawn from the market (Tr. 16,039–41, 15,758–60; CX–GM 2049A).

4. *Fixed Costs In Development And Introduction Of A New Product*

613. The third prerequisite, under complaint counsel's premise that respondents' brand proliferation has created a barrier to entry into the RTE cereal industry, is the existence of substantial fixed costs associated with the development and introduction of a new product. This requirement has been met. As I have previously found (Findings 595–99), there are significant fixed costs necessary to launch a new product including the costs of research and development, market research, production equipment and plant and introductory advertising.

5. *Crowding of the Market*

614. A market would be crowded when existing firms have packed it so densely with their brands that another brand cannot enter and generate enough sales to earn a normal return. Sales opportunities available to an entrant must be sufficient to cover the costs of introducing new brands and yield at least a normal rate of return. Fixed costs establish a certain minimum volume required to break even. Crowding deters entry because an entrant is prevented from attaining the break-even point in sales output (Tr. 21,987–88).

Complaint counsel assert (CPF 9–221) that respondents' brand proliferation activities have crowded the market so as to reduce the

opportunity for the introduction of new brands; that "[i]n some areas [or segments] of the market crowding has proceeded to the extent that the remaining sales opportunities, or holes, are so small that no one, including established firms and potential entrants, could launch a brand and expect to achieve sales sufficient to become profitable."

615. As found above (Findings 530–31, 534–89), each respondent has made a planned and concerted effort to find and seize upon every opportunity for the introduction of a profitable new product; and Kellogg and General Mills have found it to be to their respective competitive advantages to introduce new products even when they may not be individually profitable. New product introduction has outdistanced market growth, as demonstrated by the reduced market share and poundage sales of the average RTE cereal product. **[174]**

616. In the face of high fixed costs, opportunities for profitable new brand introductions declined as the number of brands on the market increased (Tr. 12,424–25; CX–K 552G, 565I–L, 604A, B; CX–GM 2178D, E, G; CX–GF 1455C). The increased number of cereals on the market correspondingly increased the possibility of new brand failures (Tr. 11,465, 11,672–74). Kellogg believed that the sodium free corn flake segment which consisted of another seller's brand, was too small to support a profitable entry by Kellogg (Tr. 12,840), and that "the market is over saturated with cocoa-flavored products" (CX–K 7205D).

617. General Mills concluded that the market is so "highly fractionated [that] opportunities to successfully introduce unique new cereal products . . . are limited" (CX–GM 2178D); and that "[t]he successful introduction of new cereal products has become increasingly difficult in a market which has reached maturity" (CX–GM 2178G). General Mills conducted a market research test which showed that the bran segment of the RTE cereal market would not support another bran product, Alive/Bran Wisps. General Mills decided not to introduce that product into the national market (Tr. 15,798–804; CX–GM 2049).

618. General Foods observed that "[t]he presweet segment is crowded with over 30 brands competing for 21 share points, for an average SOM [share of market] of less than 0.7%" (CX–GF 2021C). In 1972, it found that "subsegments of the presweet category are becoming saturated" (CX–GF 4010Z–10). For example, the unflavored, presweetened rice area would not support a new General Foods cereal, an unflavored Pebbles (Tr. 17,456–58).

619. Quaker concluded that a major inhibiting growth of the presweet cereal market was consumer "satiety" with uniquely

flavored products. So many differently flavored cereals were on the market that opportunities for new brands were limited (CX–Q 2631B). It also believed it was unlikely that an opportunity remained in the spoon-sized shredded wheat segment for an additional brand capable of reaching the 1.24% market share that Quaker estimated was necessary for profitability (CX–Q 183A–B).

620. Complaint counsel's theory that the introduction of all of the products that can profitably compete in an area will dissuade the entry of still more products is a logical one, and the situation clearly has obtained in the RTE cereal industry. This, however, is just another way of saying that competition will deter entry and the more vigorous the competition, the more likely it is that new entry will be deterred. Here, complaint counsel have merely evidenced and analyzed how competition by existing firms in the form of new products will deter entry by new firms.

621. While crowding has undoubtedly deterred new entry into some areas, the areas so precluded, their economic significance, and the **[175]**time periods of preclusion have not been identified (CPF 9–221, 9–270, CRPF 9–3, 9–38, 9–49, 9–52). This limitation of proof weakens complaint counsel's position that respondents' brand proliferation constitutes the sole reason why there has been a failure of new entry into the RTE cereal industry.

6. *Preemption*

Faced with the fact that established firms have introduced numerous brands during the period covered by the complaint, complaint counsel agree that crowding is not the complete explanation of why new firms did not enter. It is necessary to go one further step. That step is preemption (CPF 9–289 thru 9–291). As explained by complaint counsel (CPF 9–291):

> It is obvious that in a changing market entry deterrence does not result solely from the crowding effect of brand introductions. Crowding cannot be the complete explanation of entry deterrence because crowding will affect existing firms as well as new firms. However, existing RTE cereal firms and potential entrants differ in ways that account for the ability of existing firms to launch new brands while new firms cannot. One difference is that respondents' brand proliferation strategies have resulted in a more crowded market with reduced average brand market shares, thus making it more difficult for new firms to achieve efficient firm size, in the range of 3.5% to 5% of the market, without entering with several successful brands. Potential entrants, therefore, are more likely to adopt an entry strategy based on multiple brands. Respondents, having already achieved efficient firm size, do not need to locate multiple brand opportunities. They can launch single brands as the opportunities develop. A second difference is that new entrants must have different expectations as to the reactions their brand introductions would provoke from the established firms.

That difference would lead prospective entrants to be more uncertain and more cautious, causing their brand development ideas to be preempted by respondents' brand introductions (Schmalensee, Tr. 22,647). These differences lead to preemption, *i.e.*, they operated to deter potential entrants while respondents are able to introduce new products (Schmalensee, Tr. 22,113–18). **[176]**

(a) Preemption By Reason Of Economies Of Scale

622. Complaint counsel assert (CPF 9–292) that economies of scale are not reached at the firm level until the firm acquires from 3.5% to 5% of the RTE cereal market. A potential entrant would not wish to enter at less than minimum efficient size because it would then have higher costs and lower profits than the respondents and would be at a considerable competitive disadvantage (Tr. 22,115, 26,409–11). (This finding is subject to the comments contained in the paragraph following Finding 624.)

623. However, the opportunities for developing a product that can achieve sales of 3.5% to 5% of the market are practically nonexistent; and respondents, who are already operating at or above minimum efficient scale, are constantly searching for opportunities to introduce products at the 1%–1.5% level, a profitable level for them (*supra*, Finding 589). Thus, existing firms are in a position to preempt the entry of potential entrants by introducing individual products into perceptable market holes before potential entrants can develop and introduce the multiple products necessary to reach the 3.5% to 5% minimum efficient firm size. Even if a potential entrant were to consider attempting to develop a product that might achieve 3.5% to 5% of the market, respondents, by repeatedly introducing smaller volume brands, would remove the possibility that an opportunity for a 3.5% to 5% brand might come about (Tr. 22,116–19, 22,930–31, 26,409–10). (This finding is subject to the comments contained in the paragraph following Finding 624.)

624. In summary, respondents can seize every individual new product opening as it appears, whereas an outsider would have to wait for an unusually large size or for a number of smaller normal size openings; and the respondents, by seizing each individual opportunity as it appears, preempt outsiders from ever having the opportunities they require to enter. (This finding is subject to the comments contained in the following paragraph.)

Thus, potential entrants would be disadvantaged in their efforts to introduce a new product into the RTE cereal industry. The extent of that disadvantage, however, depends upon the minimum efficient firm scale facing a potential entrant. Findings 622, 623 and 624, therefore, are conditioned upon the establishment of a 3.5%–5%

share of market as the minimum efficient firm size for a viable competitor in the RTE cereal market.

625. Economies of scale are those efficiencies related to volume of output that enable larger firms to produce and distribute their goods at lower average costs than smaller firms. As firm size [177] increases, average costs per unit of production decline until a firm reaches an output level called "minimum efficient scale." Unit costs beyond that level generally stay constant. Minimum efficient scale is that level of output at which all relevant economies of scale are achieved and at which unit costs attain their minimum value. A firm with this level of output would have costs as low as any firm in the industry. A firm with an output level below minimum efficient scale would find itself operating at a cost disadvantage relative to firms with higher levels of output. If a company were to enter an industry with a level of output below minimum efficient scale, it would have costs greater than existing firms in the industry and, therefore, might not be able to earn a competitive rate of return (Tr. 21,846–47, 22,991, 26,319; CX–CI 103Z–38, Z–39).

626. Complaint counsel assert (CPF 7–126) that "A study entitled 'The Structure, Conduct and Performance of the Breakfast Cereal Industry 1954–1964,' written by Robert S. Headen and James W. McKie in 1966 ('Headen-McKie Study', CX–CI 103), . . . provides a reliable basis for determining firm economies of scale in the RTE cereal industry." The Headen-McKie Study was commissioned by the members of the RTE cereal industry through the Cereal Institute, as an industry response to an anticipated report of the National Commission on Food Marketing, and was ultimately submitted to that Commission (CX–CI 59, 60, 62, 63, 64, 75, 170R–S, 172A–B, 173E–F, 177B–C). The study examined the behavior, the character and nature of competition, and the performance of the breakfast cereal industry as it existed during the period 1954–1964 (CX–CI 103C).

627. The study, among other things, considered production scale economies as a condition of entry. In consideration of the rate of technological progress in the industry, no empirical estimates of average costs at different output rates were derived, nor were any statistical cost studies made. The only information secured was by interviewing cereal production managers (CX–CI 103Z–38–39). The study reports (CX–CI 103Z–40):

The estimates obtained in discussion revealed that:

1. It would be "economically feasible" for a new entrant to enter the market with production facilities built to supply about 1% of the national market or approximately

12 million pounds of cereal. By "economically feasible" it is presumed that production managers felt that a plant built to this scale would not be as efficient as a larger one, but that the cost disadvantage would not be so great that the potential entrant could not earn satisfactory profits. [178]

2. It was felt that a fully efficient cereal plant could be built to a scale such that it would supply about 5% of the national market or about 60 million pounds per year. It is presumed then that the production cost disadvantage of a plant of this size would be negligible.

And at CX–CI 103Z–45, it is stated:

It was estimated in the above section on possible production scale economies that an efficient cereal plant would supply between 1% and 5% of the market.

628. Apart from production costs, the study considered media availability and costs, ability to get retailers to carry a new product, cost differentials in having a company sales force as opposed to using brokers, patent barriers, raw material availability and advantages of vertical integration; and found that these did not constitute significant barriers to entry (CX–CI 103Z–29–Z–38, Z–40–Z–45).[55]

629. The Headen-McKie conclusions on firm economies of scale have no analytical or other substantive support. As conclusions drawn from conversations with production managers, and limited to production costs, they are at best a rough estimate that firm economies of scale are not fully realized until a 5% market share is reached. However, the report does not indicate the difference in production efficiencies at the 1% and 5% levels or for points in between. Accepting the report at full value, it may be that, while firm economies of scale are fully realized at the 5% level, there is not a significant difference in firm efficiencies at the 1% and 5% levels.

630. Apart from the Headen-McKie report, the record contains no study or other direct evidence bearing upon economies of scale in the [179]RTE cereal industry. Complaint counsel attempt to support and further refine the conclusions reached by Headen and McKie by drawing inferences from other matters in the record.

631. First, complaint counsel (CPF 7–129 thru 7–133, 7–141) rely on the contention that RTE cereal manufacturers (Kellogg, General Mills and General Foods) with market shares above 5% were not more profitable than manufacturers (Quaker and Ralston) with market shares approximating 5%[56] and that there was no signifi-

[55] These considerations appear to have been made on a cursory basis (Tr. 26,864–65) and do not take into account other basic costs such as distribution and marketing. I cannot accept the Headen-McKie study as establishing that the only significant economies of scale are in production.

[56] Complaint counsel's argument is premised on rate of return figures which have been found to be unreliable (*see, infra,* Findings 676–799). Contrary to complaint counsel's contention, Quaker's rate of return was considerably lower than those of Kellogg and General Mills (*infra,* Findings 792, 797). Further, costs per dollar of sales would be a more appropriate consideration in evaluating economies of scale than returns on capital (Tr. 30,618).

cant disparity between market share movement of the firms in the two groups. It is contended that, if the larger firms had a cost advantage over the smaller firms, they would either have been more profitable or they would have expanded their sales and market shares at the expense of their smaller rivals.

632. There are many factors in addition to economies of scale that account for profits and market shares. These include differences in management decisions as well as differences in the products being manufactured. It may well be that the products of a particular manufacturer are selling at maximum consumer demand, that others are losing favor in the marketplace and that efforts to develop new products are meeting with varied success. Thus, under complaint counsel's own figures (CPF 7–132), General Mills' return on capital was well above the industry average, Kellogg's was slightly above average and General Foods' was below average. And, among the firms operating near the 5% share of market figure, Quaker's return was below average and Ralston's was above. These disparities using complaint counsel's own figures would show that there are many elements that impact profits other than share of markets.

633. There is simply no reliable way, on the basis of this record, in which company profits and market shares can be related to economies of scale to the exclusion of numerous other market factors (Tr. 23,799–801).

634. Complaint counsel (CPF 7–141 thru 7–144) next rely on instances where firms which were operating at the 1% to 3.5% market share level took steps to increase their market share to above the **[180]**3.5%–5% level. The contention is made that they did so in order to achieve economies of scale.

635. Complaint counsel (CPF 7–143) rely upon the fact that when Quaker dropped into the 1%–3.5% range in the early 1940's, it expanded its operations and remained above 3.5% into the 1950's; and that when its share again fell below 3.5% in the 1950's, it introduced new brands and undertook expenditures on plant, equipment and product development with the result that it brought its share to over 7% by 1971. A similar recitation is made of competitive efforts on the part of Ralston on the several occasions its share fell below 3.5%. Actually, Ralston continued to operate at below the 3.5%–5% rate during the periods 1943–1963 and 1966–1971 (Tr. 23,515).

636. All that complaint counsel have demonstrated is that when Quaker's and Ralston's business slipped, and profits correspondingly fell, they took steps to increase their business. None of the various Quaker and Ralston documents relied upon by complaint counsel

refer to or discuss economies of scale. They discuss sales volumes and profits to be realized through greater sales.[57] Quaker wanted to grow overall and accelerated new product development in most of the major businesses it was already in including RTE cereals, hot cereals, Aunt Jemima mixes, frozen foods, Quaker corn goods, Kennel Ration dog food and Puss'n Boots cat foods (Tr. 15,111–14). There is no evidence that this growth effort was stimulated by considerations of economies of scale in any particular area.

637. Complaint counsel (CPF 7–145 thru 7–157) next point out that, generally, individual plants of Kellogg, General Mills, General Foods, Quaker, Ralston, and Nabisco have capacities to supply over 4% of the market; that those which fell below that figure were either expanded or were closed. This, it is contended, supports the reliability of the Headen-McKie estimate and the conclusion that economies of scale in the RTE cereal industry are in the 3.5%–5% range.

638. The expansion of a small plant may well reflect increased demand for the particular products made there. The closing of a very small plant may be because it is no longer needed in the business. There may be all manner of reasons for these actions unrelated to economies of scale. Dr. Scherer, one of complaint counsel's expert economists, assigns very little weight to this technique (Tr. 26,934–[181]35). Dr. Glassman, through whom complaint counsel sought to develop the relationship between plant closings and expansions and economies of scale, conceded that motivations quite apart from minimum efficient scale could have been involved (Tr. 26,945–55, 26,983, 26,975–76). Plant closings and expansions, to the extent developed in this record, therefore, do not provide probative evidence on the question of firm efficiencies of scale.

639. Complaint counsel (CPF 7–159 thru 7–162) next contend that plant capacity utilization tends to be lower for smaller firms than for larger ones. This, according to complaint counsel, means that smaller companies build plants in excess of initial requirements in the hopes of expanding production to the point of reaching a 5% minimum efficient scale. There is no substance to this argument. Any competitor has hopes for a flourishing and growing business, and would build a plant on the basis of projected future demand.[58] Further, complaint counsel's assertion as to the relative utilization of capacity of larger firms vis-a-vis smaller firms is not supported by the records (Tr. 26,971–72, 27,001–02). General Foods' capacity

[57] Any firm realizing a normal or higher return on a particular volume of sales would consider increasing its sales if, without unreasonable risk, it could realize the same rate of return on the increased sales.

[58] Of course, to the extent a particular plant is operating below capacity, the firm, being subject to constant overhead costs, could be operating below minimum efficient scale.

utilization was relatively low and dropped as it lost market share (Tr. 26,364).

640. Finally, complaint counsel assert (CPF 7–163) that the evidence shows Procter and Gamble was considering entry into the RTE cereal industry, but that it would not enter unless it could acquire between 4% to 10% of the market; and that this confirms the reliability of the 5% Headen-McKie estimate. Mr. Butler, executive vice-president and vice-chairman of the board of Procter and Gamble, contrary to complaint counsel's contention, did not testify as to the market share Procter and Gamble would require to enter the RTE cereal industry; and there is no probative, reliable evidence on this issue elsewhere in the record.

641. In summary, under Headen-McKie, which does provide a rough estimate of production scale economies,[59] it would be economically [182]feasible to enter the RTE cereal market with production facilities capable of supplying about 1% of the national market. While the entrant could earn "satisfactory" profits at that level of production, it would not achieve full production economies of scale unless it supplied about 5% of the market. The study, however, does not indicate the degree of disadvantage that a firm would be under at various levels of production below 5% down to 1%.[60] Even if a firm required 5% of the market to achieve minimum efficient scale, it would enter at a smaller volume if the cost disadvantage was not too great. It is impossible, therefore, to evaluate the extent to which preemption of new entrants by reason of their inability to achieve economies of scale has acted to deter entry.

642. As noted above, Headen-McKie estimated production economies of scale, and in a cursory manner stated that other economies of scale were insignificant. As marketing and distribution fixed costs would appear to be considerable, it appears that Headen-McKie underestimated economies of scale in areas other than production. However, there is no reason to believe that the volume required to reach production economies of scale would not also satisfy the economies of scale of the other fixed costs. Further, the companies most likely to enter the RTE cereal industry would be food distributors and possibly large retail food chains which already have

[59] While expressed in terms of market share, economies of scale are determined by unit volume irrespective of the market share that volume accounts for (Tr. 23,024, 23, 038–39, 23,506, 23,508–09). The 1% and 5% market share figures in Headen-McKie were defined as 12 million and 60 million pounds per year, respectively (CX–CI 103Z–40). These market share figures remain a rough approximation, as RTE cereal industry sales increased only 14% from 1964, the date reflected by the Headen-McKie report, to 1972 (GFX 136). Economies of scale could also vary between firms to the extent their products, ingredients and technology may vary (Tr. 22,993).

[60] While various expert witnesses attempted to evaluate the extent of economies of scale at various levels below 5% (*see, e.g.*, Tr. 23,027–29, 23,035–37, 23,517, 26,820–23, 26,827–28, 26,863, 26,870–71), there is no record or other referenced basis for such evaluations, other than an effort to construe the Headen-McKie Report.

their marketing and distribution systems (Complaint counsel's 1976 Trial Brief, Vol. I, ¶¶ 201.41, 201.43; Tr. 25,810, 25,848, 26,813, 26,836–42, 26,873, 36,839–40). Inasmuch as the Headen-McKie production economies of scale estimates were in terms of size of plant (CX–CI 103Z–40), it is unclear whether or not a food distributor could reach economies of scale by combining RTE cereal production with the production of other food products in the same plant. This reflects still further upon complaint counsel's failure of proof in establishing economies of scale for the RTE cereal industry. **[183]**

This failure carries over to the question of relief in the event of a finding of violation, where complaint counsel propose spin-offs to create firms capable of producing at least 5% of total industry output.

(b) Preemption By Reason of Anticipation of Retaliation

Complaint counsel (CPF 9–300 thru 9–307) assert that a potential entrant may be preempted from introducing a new product because of the belief that existing firms would be in a position to react more strongly against an outsider's new product than against new products of each other; that an outsider would seek a product having a larger share of the market in order to better resist such anticipated retaliation; and that while the potential entrant is delaying in seeking a larger opportunity, existing firms would preempt his entire endeavor by introducing their own products.

643. Complaint counsel's theory requires localization to the extent that an existing company's reaction can be limited to a narrrow segment of the market. As previously found (Findings 59–150, 603), localization exists to an undefined, variable degree. The theory also requires significant differences between costs at the level of entry available to new firms and the level at which firm economies of scale can be achieved. This has not been established since there has been a failure of proof with respect to firm economies of scale.

644. Further, complaint counsel's theory is just that—a theory. There is no evidence of outside entry into a segment in which respondents have been located. Therefore, there is no evidence of reaction to such entry by an outsider; nor is there evidence of planned reaction to such an entry. The only contemplated entry into a segment occupied by existing companies evidenced by the record is that of Procter & Gamble, and that company expected no stronger reaction to its entry into the RTE cereal industry than to an entry into any other industry (Tr. 25,859).

7. *Proliferation By General Foods*

645. The introduction of new brands at a gradual rate which is sufficient to offset the gradual decline in shares of older brands is not anticompetitive and does not constitute brand proliferation. General Foods' pattern of brand introductions, in the face of a steadily declining market share since 1953, constituted that kind of product introduction activity aimed at recapturing a declining share of market. It did not constitute brand proliferation (Tr. 27,429–33, 27,468–69, 27,572–73; GFX 28, 1366). **[184]**

B. *Deterrences Other Than Brand Proliferation*

646. As defined by complaint counsel's expert, Dr. Schmalensee, "There is a barrier to entry if there is a difference or a lack of symmetry between the positions of existing firms and potential entrants, such that the existing firms can earn profits while the potential entrants would suffer losses" (Tr. 22,345). The definition was subsequently restated, "Barrier to entry is a factor or condition that makes possible, or more precisely, a factor or condition that makes the situations of existing firms in an industry different from the situation of potential competitors in such a way that the existing firms can earn excess or monopoly profits persistently, and yet entry will not be attractive." (Tr. 22,381).

647. Economists disagree as to what conditions of entry are properly classified as barriers (Tr. 22,388, 23,408). There are other conditions of entry which make entry more difficult but which both incumbent firms and potential new entrants are required to overcome. Because these conditions of entry do not present an asymmetry or difference between incumbents and potential entrants, they are not regarded as barriers to entry (Tr. 23,407–08). Even barriers to entry do not bar entry. They represent obstacles to be overcome, but entry deterrence is not inevitable (Tr. 22,384).

We need not concern ourselves with the differing opinions of economists as to which deterrents to entry are properly classified as barriers. We are concerned with the extent to which any conditions of entry explain the lack of new entrants into the RTE cereal industry.

Complaint counsel have contended that respondents' brand proliferation is the sole explanation for lack of entry in that industry. As I have found, complaint counsel have espoused a logical theory why brand proliferation (which is another term for competing by introducing new brands) would act to deter the introduction of products by new entrants. The extent to which lack of entry in the

RTE cereal industry may be so explained, however, is an unkown quantity because of a failure of proof of two elements upon which the theory rests. These are: (1) minimum firm efficient scale of entrance below which the new entrant would be at a competitive disadvantage to existing firms and (2) the degree of localization of RTE cereal products.

To the extent these two elements may have an impact on a potential entrant, brand proliferation may well exert a deterrence on entry. It is not, however, the only deterrence. **[185]**

648. Because of the high capital costs associated with entry, only large firms are realistic potential entrants into the RTE cereal industry (Tr. 17,559–60, 21,857–58, 22,676, 26,155, 26,258–60, 27,022–23, 27,009–10, 26,603; CX–CI 103Z–52; CPF 9–319). Based on complaint counsel's position as to production requirements to achieve minimum efficient scale, initial costs for plant, equipment and marketing would range from $50 million to $150 million (Tr. 21,857, 27,039).

649. Of those large firms, potential entrants would be further limited to those already in the field of grocery production and supply. This is so because firms look for opportunities where their established abilities can be utilized, not merely as an exercise of existing capability, but in order to cut down their overall costs of entering and operating in the RTE cereal industry (Tr. 25,809–10, 26,259; CX–CI 103Z–52). For example, a grocery firm with a diverse line could add RTE cereal using its existing sales force and distribution system (Tr. 22,998–23,000, 26,595–96, 26,813).

650. Even the limited number of potential entrants would be cautious about entering because of the high capital costs and the long lead times in recovering capital investments (CRP 7–65; Tr. 26,155). The existence of such long lead times to develop, test and market successful products has previously been found (Findings 552–57, 568–77, 600–01).

651. Obviously, faced with a long lead time for showing profits and recovering very high investments, a potential entrant must come up with a potentially overwhelmingly successful product, one that promises a relatively high rate of return (Tr. 22,420–21, 26,624; CX–CI 103Z–52–53). The problems in coming up with such a product are considerable, costly to overcome and time consuming (*supra,* Findings 552, 596, 650). They may well be insurmountable. Procter and Gamble, the only company evidenced to be interested in entering the RTE cereal industry (other than the granola segment), began by 1960 to consider whether to enter. It started its efforts to develop a product in 1964. By 1970, it had spent between $500,000 to

$1,000,000 only to determine that the product it had developed was not suitable. While still interested, Procter and Gamble has not introduced an RTE cereal product to this date (Tr. 25,803–05, 25,833–35, 26,898, 26,903; CX–PG 60).

652. Companies enter an industry only in anticipation of profits. However, a new entrant could not be assured that its product would receive consumer acceptance. As previously found (Findings 590–94), the failure rate of new products is high and a number of other products which remained on the market failed to earn satisfactory profits (CX–CI 103Z–52, Z–53, Z–54). While the industry rate of return and the rate of return of individual competitors is a complex matter (to be addressed in the next section) and a potential **[186]** entrant would be unaware (except for Kellogg)[61] of a company's rate of return on RTE cereal (Tr. 22,669–79), a potential entrant would be aware of a disparity of success among the various RTE cereal competitors. It would know, for example, that General Foods introduced 22 products from 1950 to 1977, but that only seven such products were still on the market in 1978 (Tr. 38,136). It would know also that General Foods' share of market grew only 1% from 1958 to 1966 compared to a gross national product growth rate of 4.9% (GFX 27). It would have observed General Foods' costly failure in its attempt to produce and market RTE cereals with frozen dried fruits (Tr. 36,382, 36,384, 37,181; GFX 1211, 1212; CX–GF 571). It would have observed General Foods' decline in market share from 25.3% in 1951 to 17.1% in 1973 and Nabisco's decline in market share from 12.5% in 1945 to 4.9% in 1973 (CX 106B). A potential entrant would not normally anticipate emulating the apparent success of the leading company, Kellogg (Tr. 26,554), but would be forewarned of risks by the experience of other competitors. And General Foods' growth rate and experience would indicate a degree of risk and lack of attractiveness for new entry (Tr. 27,420–21).

653. This observation of high risk would deter a potential entrant from entering the RTE cereal industry, unless it could foresee a rate of return higher than normal in order to compensate for the risk it would be incurring (Tr. 22,389–90, 23,237, 26,584, 38,517).

654. Entry must be made with a product that is perceived by consumers to be meaningfully different. "Me-too" products, products without significant differences, are likely to be failures (Tr. 9184–88, 12,965, 14,516–25, 14,584–86, 14,966–67, 15,228, 15,847, 15,851–53, 15,952, 17,453, 17,627–31, 17,634, 17,650, 22,720, 26,549; CX–K 396B). Since the introduction of presweets in 1950, nutritional cereals and

[61] Since Kellogg was almost entirely in the RTE cereal business, its reported profits would reflect its success in that industry.

then natural cereals, no products encompassing new basic concepts have entered the market (CX–GF 4010Z–2). Therefore, it takes a considerable amount of research and development, market research and basic know-how to come up with an acceptable product. With six major companies already experienced in the field constantly seeking to fill every new product opportunity, the difficulties of a would-be entrant to come up with an acceptable product are apparent. Witness the so-far unsuccessful efforts of Procter and Gamble. The extent to which companies already in the market have advantages over would-be entrants adds to the impediments to entry. The advantages vary in degree but, taken together, they may constitute a significant impediment to new entry.

655. The incumbents have the advantage of being in place with products that overall constitute a full line or lines (Tr. 26,554, **[187]** 26,760, 30,576). Not only do the existing products have an advantage over new products by reason of brand loyalty, but that brand loyalty carries over to new products of existing companies (Tr. 15,098–99, 15,165, 30,584–85).

656. Another advantage is the experience and technological know-how of insiders, not only as reflected in the individual capabilities of their employees, but as developed as a team or group effort.[62] New entrants do not have all of the skills of existing firms. It takes time to develop those skills. This is referred to as the learning curve. As cumulative experience is gained under the learning curve phenomenon, costs go down (Tr. 23,488, 27,321, 30,495–96, 30,542–43).[63] This is a disadvantage to new entrants which require time to develop necessary skills (Tr. 27,321, 30,543–44).

657. Even existing firms lack the know-how to produce certain categories of products and to duplicate some of the products of their competitors (Tr. 22,987–99, 32,995–96, 33,133, 33,209). This lack of know-how would be an even greater handicap to a new firm attempting to produce a targeted product. In building its second RTE cereal plant at Modesto, General Foods attempted to replicate the equipment it had in place at Battle Creek. Battle Creek engineers participated in the design of the Modesto plant. A Battle Creek foreman supervised training. Key Modesto personnel were sent to Battle Creek to work in that plant and gain as much experience as

[62] Product and equipment development and maintenance, as well as production itself, at General Mills is accomplished by teams of personnel working together (Tr. 29,304–06, 32,786–87, 33,004, 33,219). Team leaders are promoted from the inside, but only from those who have had at least eight years of experience (Tr. 32,997, 32,999–33,000, 33,002–03).

[63] Employees of General Mills have been able, over time, to increase their productivity and reduce costs (Tr. 36,664, 36,670, 36,682–84).

possbile. Battle Creek technicians supervised the Modesto start-up (Tr. 36,691–93). After nearly two years of operation at Modesto, General Foods obtained an output on the Raisin Bran/Bran Flakes line of 55.5% of the raw material input. This compares unfavorably with an 80% yield at Battle Creek (GFX 1347).

658. After three years of production, Ralston's Lancaster plant had a lower yield on flakes than Ralston's Battle Creek plant. Ralston attributes this to the lower level of experience and knowledge on the part of the Lancaster plant personnel (Tr. 10,693, 10,755–56).

659. The costs to Ralston in 1969 of producing its Chex products at its Cincinnati plant, after ten years of operation, exceeded the [188]costs of producing those products at Battle Creek, a plant built in 1928, by from 1.9 to 3.8 cents per pound. Yields were higher in Battle Creek than in Cincinnati (Tr. 10,693, 10,755–56, 23,489–91, 23,897). Ralston's Director of Production would attribute this difference to "experience, length of operation and personnel knowledge" (Tr. 10,756). Ten years would seem to be long enough to overcome all learning curve requirements. While I do not find that the learning curve phenomenon explains the lower efficiency of Ralston's Cincinnati plant, we do have these three instances where more recently built plants are less efficient than older plants of the same companies.

660. Manufacturing multiple products as they do, and with fluctuations in the success of particular products including failures, respondents frequently have excess capacity that they can use to manufacture new products (*see, e.g.,* Tr. 13,481; GFX 423C). Thus, whereas an insider need only consider operating costs, a new entrant would have to build capacity and cover both fixed and operating costs (Tr. 13,057–61, 13,481–83, 13,656, 13,994, 17,832–33, 23,090–94, 25,862, 29,890, 35,829–30; CX–GF 461, 4039G, Z–3 thru Z–4, Z–61 thru Z–63).

661. The only entry into the RTE cereal industry during the period covered by the complaint has been into the granola or natural cereal segment. Complaint counsel contend that entry was possible here since respondents had overlooked this segment, so that there was no brand proliferation which otherwise would have imposed a barrier to new entry.

662. Lack of existing competition certainly created a greater degree of opportunity for new entrants (Tr. 25,915–18). Entry into the granola segment, however, cannot be equated with entry into the remainder of the RTE cereal industry. Granola is a simple product to

produce. Very small manufacturers can produce granola on unsophisticated machinery,[64] without any research and development and with very low capital investments (Tr. 21,858, 23,471–72, 37,298, 37,300).[65]

663. By 1970, the granola segment accounted for 9% to 10% of the RTE cereal market (Tr. 29,678, 36,622). Competition existed among many companies, including Kellogg and General Mills which entered in response to the entry of others (Tr. 13,087–88, 17,802). **[189]**

664. Among those that entered the RTE cereal industry with natural cereal products were Pet, Pillsbury, Colgate and International Multifoods (Tr. 25,912–13, 26,487, 26,491–92). Pet was the most successful with its Heartland product which, at one time, attained a 2.1% market share (Tr. 22,934). These firms, after some initial success, all withdrew except for Pet which has become an insignificant participant (CX 434D). Carnation had been in the RTE cereal industry for some 20 years, but exited in the 1960's (KX 35). Pillsbury had previously exited in the 1930's and then again exited from the natural cereal segment in the 1970's (Tr. 26,334, 26,492). H. J. Heinz was in the industry in the 1930's and exited sometime prior to 1958 (Tr. 12,992, 26,489; KX 35). Potential entrants would have been dissuaded from entering the RTE cereal industry by the noted inabilities of these major grocery product companies to compete successfully (Tr. 26,511–13).

665. Respondents are charged with responsibility for lack of entry since 1950 when, it is alleged, they turned from price competition to brand proliferation. Yet, the industry was experiencing growth and respondents were flourishing in the 1940's and there was no entry during that period (Tr. 26,112; GFX 1366). Thus, no change in entry was effected by respondents' alleged change in competitive activity around 1950.

666. A growing market is normally an attractive one for entry since this reflects opportunity for a new product to share in the growth rather than simply try to take business away from existing products. Therefore, entry into such a market is less likely to provoke strong retaliation (Tr. 26,156–57).

667. For the overall period 1952–1966, RTE pound sales grew by 72.8% whereas the "all goods and services" Gross National Product ("GNP") grew by 63.9% (Tr. 26,158). However, for the period 1958–1966, RTE cereal pound sales increased 32.9% while the GNP went

[64] The manufacture of granola is so simple that it can be accomplished using the facilities of an existing bakery (Tr. 37,277).

[65] Organic Milling initially expended $1,000 and then expended annual sales to $1 million on additional expenditures of $10,000. Sales reached $3 million with total capital expenditures of some $65 thousand.

up 42.1% (GFX 25). Further, the RTE cereal industry experienced a period of "no growth" from 1966 to 1970, which would have made entry into the industry relatively unattractive (Tr. 26,157–58).

Summary

668. Respondents have engaged in intense, uncoordinated competition in the introduction of new products. This competition is not unlawful nor was it induced by other unlawful activity.

669. Obviously, the more successful new products introduced by respondents and other incumbents, the more saturated the market and the less requirement and opportunity for the introduction of new products by outsiders. By the very nature of differences in demand (*e.g.*, presweets, natural, fortified, bran, flavored), products are to be a degree localized, and a new product would to a degree be limited as to the segment from which it could attract its users. **[190]** Individual products account for lower market shares and smaller poundage of sales than formerly. The industry has become one of relatively small volume brands.

670. Incumbents are at an advantage over potential entrants in developing and marketing acceptable new products. They can utilize existing research and development, market research and other expertise in locating opportunities and developing products to meet perceived demand. They can also utilize unused capacity for production of a new brand, whereas a new entrant would have to build that capacity.

671. Respondents and other incumbents are not only capable of finding and taking advantage of an opportunity before a potential new entrant, but, because of economies of scale, are in a position to take advantage of smaller opportunities.

672. Would be entrants are faced with substantial fixed costs in research and development, market research, plant production equipment and introductory advertising. To the extent the requirement exists to introduce multiple products, the costs would multiply. Potential entrants, therefore, are limited to large firms, primarily those already producing and supplying grocery products who can utilize their existing expertise and so minimize costs of entry and operation.

673. The limited number of potential entrants would exercise caution in actually entering because of high capital costs, long lead times in developing and marketing acceptable products, extended periods even after entry in reaching levels of profitable operation and recovering capital investments, and the high risk that a product

may prove unacceptable at various stages up to national entry or may fail after entry. Indeed, the problems of developing an acceptable product with which to enter may be insurmountable.

674. While potential entrants would be aware of the publicly reported profitability of Kellogg, they could not hope to emulate the most successful company. Their desire to enter would be tempered by their observation of others in the industry. They would hesitate knowing of the failure of General Foods in marketing its cereals with fruit and its loss of market share, and of Nabisco's decline in market share. Potential entrants would also hesitate because of the observed inability of Pillsbury, Colgate, International Multifoods, and H.J. Heinz to remain in the market and the limited success of Pet.

As stated at the very beginning of this section, complaint counsel's theory of the existence of a barrier to entry into the RTE cereal industry is premised on the assertion that the industry has enjoyed supracompetitive profits and rapid growth; and that the absence of entry under these conditions indicates the existence of a barrier to entry.

675. While there was overall substantial growth from 1952–1966, growth from 1958–1966 was below that of the GNP and the industry was **[191]**in a period of no growth from 1966–1970. This leaves for determination the very first premise of complaint counsel's barrier to entry theory—the enjoyment by the industry of supracompetitive profits. I have left this opening premise until last since it falls within a very complex, highly contested set of issues involving industry performance. This will be dealt with in the next section.

VI. PERFORMANCE

A. *Economic Theory of Performance Espoused By Complaint Counsel*

As previously noted (pp. 22, 28–29), complaint counsel are relying upon a structure-conduct-performance analysis of the RTE cereal industry in their effort to show a violation of law. Findings on industry structure and respondents' conduct have already been made. This leaves an analysis of performance to which we now turn.

The following analysis of performance is derived from complaint counsel's introductory definition and explanation of that subject (CPF 11–1 thru 11–17). It shows preliminarily the burden of proof they have assumed.

Performance. This is the degree to which an industry serves the consumer and can be defined in terms of three major goals (Tr.

27,661). These three goals are: (1) to maximize the efficiency with which an industry and the economy overall operate; (2) to charge prices low enough so that excessive profits are not reaped from consumers ("equity"); and (3) to maximize producer progressiveness (Tr. 27,652, 27,661).

Efficiency. Competitive industries maximize efficiency in two ways. First, firms in an efficient industry will minimize their costs, and so avoid waste of production resources (Tr. 21,693, 27,655). The second form of efficiency is termed "allocative efficiency." When an optimal level of allocative efficiency is obtained, prices are kept at cost (including a normal rate of return), consumers demand and are able to purchase the greatest quantity of the good, and an optimal level of resources is devoted to production of the good (Tr. 21,695–96, 26,153, 27,652–54).

The economic law of demand is that the higher the price, the lower the quantity demanded of a good (Tr. 27,992–93). Whenever an industry prices above the competitive level, consumers demand less than they normally would, output is restricted and, thus, resources which should have been devoted to production of the good will be diverted to other goods. A misallocation of resources results (Tr. 21,692, 21,695, 21,707, 26,153, 27,652). Where there are excess profits, resources are being misallocated (Tr. 21,814). With free and open competition and prices kept at competitive levels, supply **[192]** and demand reach appropriate levels and consumers spend appropriate amounts for the good. In the absence of such free and open competition, consumers will spend lesser or greater amounts for the good and, correspondingly, will spend more or less on other choices. Thus, resources would be misallocated. The resultant losses when resources are misallocated are called "deadweight" or "welfare" losses (Tr. 27,999–28,000).

Consumers lose due to an industry's cost inefficiency. With competitive pressure, firms within a competitive industry strive to minimize their costs. When all firms minimize their costs, the industry's average level of costs goes as low as possible and the quantity of the product demanded by consumers would be at the greatest level that would permit firms to earn a competitive rate of return. However, in monopolistic industries, costs may be unduly high. For example, firms may be inefficient due to poor management, yet be able to survive because they are insulated from competition.

Equity. If an industry is performing equitably, neither prices nor profit levels will exceed those needed to attract the required amount

of capital to the industry. When prices, and therefore profits, are held unnecessarily high, income is being transferred unfairly from consumers to producers, consumers are injured, and performance is poor (Tr. 27,658–60, 27,991–92). Excess profits are earned whenever consumers must pay more for a product than is necessary to cover all the costs of distribution and production, including a "normal" return to the capital invested (Tr. 21,692, 21,707, 27,991–92). Persistent excess profits are evidence of poor performance and monopoly power (Tr. 21,790–91, 26,100–01, 27,991–92, 37,934).

Excess profits are also called "supranormal profits," "supracompetitive profits" or simply "monopoly profits" (Tr. 21,707, 26,090, 27,991–92, 37,934). An industry that reaps monopoly profits for a persistent period of time is said to be exercising "monopoly power" (Tr. 21,707, 26,081, 37,934). Monopoly profits show that consumers are being overcharged (Tr. 21,707, 27,991–92).

Progressiveness. Industries that perform well are progressive in taking advantage of new technological developments in order to increase efficiency. They also strive to offer superior new products and improvements of existing products to consumers (Tr. 27,655).

Underlying both equity and efficiency is the principle that the lower the price of a good, the greater will be the quantity demanded by consumers (Tr. 27,992–93).

Profits As A Measure of Performance

Performance is initially appraised by an analysis of profits. Economists commonly analyze profitability to determine an industry's level of performance (Tr. 21,692, 26,105). Monopoly power is the **[193]**ability of firms in an industry to hold prices above competitive levels (Tr. 21,707, 26,100–01, 27,934). Profitability is frequently examined to determine the existence of monopoly power, because if firms have been able to avoid competition, it is likely that profits will exceed competitive levels and will do so persistently over time (Tr. 26,100–01). Persistent high profitability indicates that competition has not been vigorous (Tr. 21,790–91).

Respondents take issue with many of the principles expounded and developed by complaint counsel that have been recited above. There is basic agreement, however, that the degree of respondents' and other industry members' profits is an important issue in this case, preliminary to reaching the other issues referred to above.

B. *Profits*

1. *Accounting Vis-A-Vis Economic Rates of Return*

676. Complaint counsel have elected to measure and evaluate profit in terms of rates of return on capital employed. This is an appropriate means of measuring profits for purposes of this case and is preferable to other measures, such as return on equity or return on sales (Tr. 19,069–71, 21,758–59, 31,288, 31,290).

677. Capital employed is the sum of all capital supplied to a firm by stockholders, in the form of equity or stock purchases, plus debt, such as bond issues; *i.e.*, total assets minus current liabilities plus the debt included in current liabilities (Tr. 19,160, 19,169–70, 20,172). Since the investment base in the accounting rate of return includes capital supplied by both equity and debt, the income measure or numerator of the ratio includes income or payments to both forms of investment. The income measure, therefore, is net income to the firm after taxes (the monies available for distribution to stockholders) plus interest on the debt included in capital employed (Tr. 19,070). This corresponds to a return on net assets.[66]

678. Economists and other business analysts have traditionally relied on accounting rates of return to measure both firm and industry profitability (Tr. 19,071, 21,698, 22,301, 31,373, 38,224–25). However, more recently, economists and financial analysts have **[194]**come to recognize serious shortcomings in the use of such accounting measures to judge firm performance, especially in certain industry settings (Tr. 19,045, 19,333–34, 26,106–09, 31,213, 37,954).

679. All of the economic experts who testified in this case agreed that accounting rates of return could be unreliable and misleading by overstating the profitability of a firm or industry (Tr. 13,336–41, 19,049, 19,332–36, 19,352, 19,361–62, 19,358–59, 19,987, 21,700, 21,705–06, 25,288–89, 26,116–18, 31,177–78, 37,493–94, 37,951–52, 38,182, 38,478–79). Dr. Stauffer, who was retained by the Commission to update its profitability analysis (Tr. 26,114–15), and who was its primary witness on the issue of profitability, was of the opinion that:

> . . . rate of return as conventionally computed by accountants . . . is seriously in error, generally having an upward bias and thus overstating the economic rate of return of the firms (Tr. 19,987; KX 17, p. 97).

He believed that accounting rates of return can be quite imperfect

[66] This tends to understate Kellogg's asset base to a slight degree and so biases Kellogg's rate of return slightly upward relative to most other firms, since Kellogg is able to finance its operations through noninterest bearing liabilities (Tr. 31,284–85).

and significantly misleading by overstating profitability (Tr. 19,352, 19,358–59, 19,361); and that the biases would be most substantial in overstating rates of return for industries and firms that engaged in a lot of research and development and advertising and also where there were substantial time lags between investments and the receipt of returns on the investments (Tr. 19,336–41, 19,361, 25,288–89). As previously found, all of these conditions exist in the RTE cereal industry.

680. Recognizing the shortcomings of accounting rates of return, Mr. Michael Glassman, then Assistant Director for Economic Evidence of the Commission's Bureau of Economics, arranged for the employment of Dr. Stauffer who developed the economic rates of return relied upon by the Commission in this case (Tr. 26,101–02, 26,114–15).

681. The fundamental difference between an accounting and an economic rate of return concerns timing (Tr. 19,069, 19,332–33, 31,177, 37,951, 37,490). Timing relates to when moneys are spent by a firm, and when the incomes associated with those expenditures are received. The economic value of dollars received two years after investment is greater than dollars received five years later (Tr. 19,332–33, 19,336–41, 19,386, 38,478–79). Generally, the more lagged the cash flow of receipts relative to the cash flow of expenditures, the higher will be the disparity between the accounting rate and the economic rate (Tr. 31,178). Nevertheless, a dollar is recorded as a dollar in the books of account of a company regardless of the length of time between the investment and the receipt of money that is generated (Tr. 37,951).

682. Accounting and economic practices differ with respect to timing of both expenditures and receipts (Tr. 19,332–33). These **[195]** timing differences frequently are associated with the different practices of accountants and economists with respect to advertising, research and development and depreciation (Tr. 19,069, 19,333). Timing differences can result in an accounting rate of return that is not an accurate measure of the economic rate of return (Tr. 31,177–78).

683. The difference between accounting and economic rates of return is illustrated by an example in the record of a firm which produces whiskey, which it ages for eight years. If it is assumed that it costs the company $1 to prepare a barrel of whiskey which the firm sells eight years later for $2, the firm makes $1 of accounting profits at the time of the sale. The accounting rate of return for the transaction is 100%, based on an original investment of $1 and the profit of $1. An economist views the transaction differently. An

economist would ask at what interest rate one could have invested the $1 to yield $2 eight years later. The economic rate of return is that interest rate. Thus, in this example, the economic rate of return is 9.05%, because if the distiller had invested $1 at 9.05%, he would have had $2 at the end of eight years.

684. In the example, the economic rate of return was 9.05% because that interest rate would yield $2 on a $1 investment in eight years. More technically, the economic rate of return is defined as the rate of discount (interest rate) under which the discounted present value of all cash inflows over the full life of a firm's investments is equal to the discounted present value of all cash outlays (Tr. 19,340–41, 31,171–72, 37,489–90, 37,944–46).

685. There may also be differences between accounting and economic rates of return caused by the accountant's treatment of research and development, advertising and depreciation (Tr. 19,333).

686. Accountants treat all research and development ("R&D") as a current expense (Tr. 19,342, 19,504). This means that, in computing profits, all expenditures on R&D are deducted as expenses from the firm's total revenues in the year in which the money is spent. R&D is similar to fixed assets, however, in that it generates revenues for the firm over future periods of time (Tr. 19,342–43). The accounting treatment of R&D may cause a distortion in the true rate of return because today's income is being charged for expenses that produce benefits in the future (Tr. 19,342–43).

687. Advertising expenditures also may cause differences between the accounting and economic rates of return (Tr. 19,333). Advertising has some effects which occur quickly, but it also has effects that are longer lived (Tr. 19,359–60). Some of the effects of advertising will be realized in the same accounting period as that in which the expenditures are made (Tr. 19,359–60). However, a portion of the benefits will occur in future accounting periods (Tr. 19,360, 26,106–07). Accountants treat all advertising as a current expense, charging it all to the year in which it is incurred, even though it may benefit future years (Tr. 19,360). To the extent that the revenues or benefits generated by advertising do not occur **[196]**in the same year as the advertising expenditure, an accounting rate of return does not provide an accurate measure of the economic rate of return (Tr. 19,361).[67]

688. Depreciation practices are another source of difference between accounting and economic rates of return (Tr. 19,333, 19,362–

[67] In addition to R&D and advertising expenses, portions of expenditures relating to market research, test marketing, promotions, establishment of a distribution system and quality control, are of a quasi-capital nature and their treatment as 100% immediate expenses on books of account tends to overstate true rates of return (Tr. 25,322–25, 25,332–33, 26,574–77, 29,852, 37,622–25, 37,712).

63, 21,701–02, 31,191–95). Depreciation is the cost to a firm associated with "using up" an asset purchased by the firm to generate future income. This means that if a firm purchases a machine at a given point in time it must subtract from its revenues a charge for using up (depreciating) that investment over some period of time (Tr. 19,363).

689. Accounting depreciation is determined by accounting conventions which are based on convenience, uniformity or other considerations apart from economic significance. Economic depreciation is a function of future cash flows (Tr. 19,362–63). Since accounting conventions do not necessarily (or even usually) reflect the actual timing of the benefits received from an investment in fixed assets, a bias in the accounting rate of return results (Tr. 31,195).

690. Accounting rates of return distort true rates of return because of the accounting conventions associated with depreciation. Accountants have conventions for stating the estimated life of investments which may or may not correspond to the true or economic life of the investment. They then amortize the amount of the original investment over its estimated life in form of depreciation expense. The economist, on the other hand, is interested in the true investment life and the amount and pattern of cash flow generated by the investment over time (Tr. 19,362; CPF 11–66). Cash flow does not include a deduction for depreciation (Tr. 19,366, 19,373, 19,376, 19,394, 21,701–02). Only under very special circumstances would accounting and economic depreciations be the same (Tr. 19,362).

691. One reason for the difference results from the rules used for tax depreciation purposes. Firms have been permitted by the IRS to take more rapid depreciation for tax reporting than they would for normal bookkeeping purposes. Firms use various accelerated depreciation formulae for tax purposes. In general, firms use accelerated depreciation because it is in their interests to use the most rapid depreciation schedule allowable under the tax code **[197]**(Tr. 19,363, 19,409–10). Again, this accounting convention of understating the true life of a fixed asset overstates the economic rate of return on investment.

692. Taking particular note of the large capital investments, the extremely high rate of advertising, the extensive amount of R&D and the long delay in securing a return on investment,[68] I find that

[68] The larger the magnitude of such expenditures and the longer the delay in securing a return, the larger the bias in the accounting rate of return, *i.e.*, the more the accounting rate of return is greater than the economic rate of return (Tr. 25,363, 37,621).

economic rate of return, not accounting rate of return, is the appropriate measure to be used in appraising profits enjoyed in the RTE cereal industry and in making comparisons among respondents, with other companies and with other industries.

2. *Methodology Of Computing Economic Rates Of Return*

693. The economic rate of return for a project can be measured if one knows how much has been invested in it and can identify and measure the cash flows or benefits associated with the investment. Thus, if one knows, for example, that a company has invested $100 in a particular project and that the cash flow generated by that project is $30 a year for ten years, the economic rate of return can be computed from tables or by calculation. The formula for the economic rate of return for a single project is widely used by bankers, economists and insurance brokers (Tr. 19,366–72).

694. The determination of the economic rate of return for an ongoing firm, which may be viewed as a collection of projects, is a much more complicated matter. Dr. Thomas R. Stauffer has devised a formula to make such a determination. This formula is a pioneering contribution in the field and was the subject of Dr. Stauffer's doctoral dissertation in economics at Harvard University. Other doctoral dissertations in economics at Harvard have applied his formula in the analyses of specific industries (Tr. 19,373, 19,378–79, 19,385, 21,759–64). This formula was applied by Dr. Stauffer in the instant case.

695. Dr. Stauffer's formula starts with an accounting rate of return and from it calculates an economic rate of return. It is necessary to know the investments a firm has made and identify the cash flows associated with those investments. However, as noted above, there are accounting conventions that govern the way a firm's accounts are set up, as well as accounting rules which govern tax liabilities which, in turn, affect the firm's accounts. **[198]**Dr. Stauffer's formula takes into account various accounting conventions and tax rules and makes certain assumptions, including that of the pattern of cash flows (Tr. 19,374–79; CX 702B).

696. Dr. Stauffer's calculation of the economic rate of return involves an equation which has four terms, the sum of which equals the accounting rate of return. Each term of the equation takes into account, and adjusts for, potential biases in the accounting rate of return. There is a "base" term which deals with the firm's investment in fixed assets and working capital, terms relating to advertising and research and development, and a term which

corrects for the difference between corporate and tax accounting rules (Tr. 19,379–82, 19,485–87; CX 702C, M).

The Base Term

697. The base term in the equation reflects the contributions to the income of the firm generated by investments in fixed assets, such as plant and equipment, and working capital such as cash and inventories (Tr. 19,491). Estimates were made as to how long assets would earn income for the firm. These estimates were necessary because they relate to the timing of revenues associated with investments. This "service lifetime" is included in the base term. The average service lifetime of assets purchased by a firm was calculated by Dr. Stauffer from data available from each firm's books of account (Tr. 19,411–15, 19,442–49, 19,451–54; CX 702G–H).

698. It was also necessary to assume the average time interval between the investment in fixed assets and inventory, and the first generation of revenues from the investment (Tr. 19,406, 25,576). This lead time assumption is the average for all types of assets, including assets with short lead times such as inventories, automobiles and typewriters (Tr. 19,406–09, 25,576, 25,580).

The Research and Development Term

699. The second term of Dr. Stauffer's economic rate of return equation relates to the contribution of research and development to income. It is intended to correct for the bias in the accounting rate of return caused by the accounting treatment of R&D as a current expense (Tr. 19,342–43, 19,504–05, 19,508; CX 702 O). As part of the R&D correction, it was necessary to make an assumption concerning the time interval between the expenditure of funds for R&D and the first receipt of revenues associated with those expenditures (Tr. 19,424–25, 19,510–11).

The Advertising Term

700. The third term in the economic rate of return equation relates to advertising. It reflects the contribution of advertising **[199]** to accounting income (Tr. 19,520, 19,485–86; CX 702C, M). This correction was necessary to account for the revenue and income for the firm generated by advertising for a period extending beyond the year in which the expenditures were made and were deducted from accounting income (Tr. 19,360).

The Depreciation Term

701. The fourth term in Dr. Stauffer's formula adjusts for differences caused by the accounting method of treating depreciation (Tr. 19,380, 19,540; CX 702C, Q). The term takes into account the economic value of the timing difference which results from the use of a more rapid depreciation schedule for tax purposes than the schedule used for book purposes. The formula corrects for the effect on the accounting rate of return of the difference between tax depreciation and book depreciation (Tr. 19,412, 19,544–45).

The Cash Flow Profile

702. Since the pattern and timing of cash inflows earned by a firm plays an important role in calculating the economic rate of return, in order to calculate the economic rates of return, Dr. Stauffer made assumptions concerning the actual pattern of cash inflows earned by each company (Tr. 19,386, 24,942–44). The assumed pattern of cash inflows is called the cash flow profile assumption and is included in each of the four terms of the equation, (*i.e.,* 1. base term; 2. R&D term; 3. advertising term; and 4. depreciation term) (Tr. 19,495, 19,514, 19,525, 19,541).

703. Two alternative shapes were assumed by Dr. Stauffer for the cash flow profile: the triangular and the rectangular (Tr. 19,387, 24,944–47). These names reflect the shapes of the graphs of the annual cash flows for the two assumptions (CX 702D). The two shapes were chosen as upper and lower bounds for the cash flow profile. The actual cash flow profile, according to Dr. Stauffer, lies somewhere in between these two extremes (Tr. 19,386–87, 19,394–96, 24,944–47, 24,954). The underlying assumption for a rectangular cash flow profile is that the cash flow produced by an asset is the same in each year for the entire life of the asset. The assumption underlying the triangular cash flow profile is that the cash flow produced by a new asset starts at a high level, and declines steadily over the life of the asset (Tr. 19,394–95, 24,944; CX 702D). The shape of the cash flow profile had to be assumed, rather than calculated, because Dr. Stauffer could not directly ascertain its shape from available data (Tr. 19,397).

While respondents uniformly agree that Dr. Stauffer's formula for reaching economic rates of return is much superior to relying upon an **[200]**accounting rate of return analysis, they do object to a number of Dr. Stauffer's inputs into his formula. The first objection is to the accounting data used by Dr. Stauffer.

(a) Accounting Data Allocations

704. The first, and very critical, step in reaching an economic rate of return is to segregate and allocate the accounting data (assets, liabilities, costs and expenses) that pertain to the RTE cereal business of the company being studied (Tr. 20,166).

705. General Mills, General Foods, Quaker and Ralston are engaged in various lines of business in addition to RTE cereals. Expenses were incurred and assets employed in the joint or common support of two or more of these lines of business without allocation by those companies to the particular businesses. For example, the records of General Mills show only operating profits based upon operating costs which include such activities as manufacturing, distribution, advertising and selling. These operating profits are before any charges for interest, taxes[69] and a group of costs called unallocated corporate expenses. Major items included in unallocated corporate expenses are salaries of the top officers of the company, executive incentive payments to such officers, contributions and airplane operations and maintenance (Tr. 18,154, 18,173, 18,265, 18,275; CX–GM 2486D). Similarly, these firms did not maintain records showing the portion of balance sheet values for all assets associated with their RTE cereal business (Tr. 18,178–89, 18,301–02, 18,305; CPF 11–21).

706. Identifying the accounting data that is applicable to RTE cereal is important because the accounting data chosen is one of the most influential inputs to Dr. Stauffer's economic rate of return calculations. Inasmuch as General Foods, General Mills, Quaker and Ralston have substantial joint assets, liabilities, costs and expenses which are not broken down by business endeavor,[70] it was **[201]** necessary to allocate to the RTE cereal business an appropriate portion of those items. Those allocations had to be made by means of estimates (Tr. 18,148, 20,166).

707. The following discussion of allocations will be limited to General Mills and General Foods since Kellogg's, Ralston's, and Nabisco's accounting data were not analyzed by Dr. Mellman and

[69] Similarly, since General Foods pays taxes on a company-wide basis, it has no need to develop such figures as "accrued taxes payable" or "provisions for income tax" solely for its RTE cereal operations (Tr. 16,299). Yet, such figures are necessary to obtain RTE cereal line of business data which is as complete and accurate as possible for comparison with other companies.

[70] For example, in 1972, corporate interest and unallocated corporate expenses amounted to 42% of General Mills' total corporate consolidated earnings before tax (CX–GM 2486). The rate of return estimates, therefore, are highly sensitive to the amount of these expenses allocated to the RTE cereal operation.

Kellogg's business during the complaint period was virtually all RTE cereals. Thus, allocations of joint costs and assets were unnecessary to arrive at its RTE cereal accounting rate of return (Tr. 12,036–37). The minor adjustments that were made to Kellogg's accounting data by complaint counsel's accounting expert, Dr. Mellman, are not challenged (Tr. 20,171–72; KPF 5–71).

allocations of Quaker's figures amounted to only .03% on its accounting rate of return for years 1956–1972 (CX 701M).

708. There are no uniformly accepted accounting principles for allocating joint and common costs, expenses, assets or liabilities to individual segments of a business (Tr. 20,599). The President of the National Industrial Conference Board has concluded, "It is evident from the multiplicity of plans uncovered by this year-long study that there is no one best method of allocating central expenses. What is desirable in one situation sometimes proves to be inadequate or misleading in another" (Foreword to C. Baumes, *Allocating Corporate Expenses,* National Industrial Conference Board, Inc. (1963)). Among those in common use are sales dollars, sales units and costs (Tr. 38,024–25; GFX 1332Z–132).

709. The Federal Trade Commission's Bureau of Economics has indicated that it will use a variety of allocation bases in processing line of business data:

> In processing the LB data, the FTC staff will apply plausible, alternative non-traceable cost allocation rules—*e.g.,* allocation according to sales, assets, payroll, and contribution margin [profits]—and test the sensitivity of calculated operating income figures to those alternatives (Bureau of Economics Staff Memorandum - 1974 Form LB Revision, at p. 5).

710. When detailed information on the make-up of a joint cost is unavailable, allocation methodologies are necessarily somewhat arbitrary (Tr. 21,036–52, 28,715–17). **[202]**

711. All parties agree that the standards published by the Cost Accounting Standards Board (CASB), Section 403 (4 C.F.R. 403), which relate to accounting standards for government contracting, constitute an appropriate guideline for use here (Tr. 20,162–64, 35,907–08; CPF 11–34; KPF 5–78, 5–79; GMPF 3–48).[71]

712. CASB Section 403 provides that any home office expense that is directly identifiable with particular segments should be allocated directly to those segments. For the residual, the allocation should be based, to the maximum extent possible, on cause/effect relations. If after making that allocation, there is still a residual, that residual should be allocated on the basis of a surrogate for causal or beneficial relationships. If after that allocation, there still remains a residual, the standard provides that a three–factor formula should be used to allocate it. The three factors consist of payroll dollars, operating revenue [sales dollars], and tangible

[71] A Bureau of Economics staff memorandum accompanying the Commission's Line of Business reporting form suggests use of CASB standard 403 (Bureau of Economics Staff Memorandum—1974 Form LB Revision, at p. 5).

capital assets plus inventories (Sections 403.20(a), 403.40(a)(1); Tr. 35,907–09, 35,923–26).[72] CASB 403.50(b)(1)–(2) (4 C.F.R. Section 403.50(b)(1)–(2)) provides in part:

> . . . The allocation of centralized service functions shall be governed by a hierarchy of preferable allocation techniques which represent beneficial or causal relationships. The preferred representation of such relationships is a measure of the activity of the organization performing the function. . . . (2) Where neither activity nor output of the supporting function can be practically measured, a surrogate for the beneficial, or causal relationship must be selected. Surrogates used to represent the relationship are generally measures of the activity of the segments receiving the service. . . . Any surrogate used should be a reasonable measure of the services received and, logically, should vary in proportion to the services received.

713. The CASB has recognized that a cost basis is an appropriate surrogate for the activities managed, including general and [203] administrative expenses, under certain circumstances (CASB 410, 421; 4 C.F.R. 410.106–410.50, 421).

714. It is clear, therefore, that there are a number of alternative cost accounting methods for allocating joint assets, liabilities, costs and expenses, and that none of the methods has been authoritatively declared to be superior to any of the others. Certainly, none has been dictated for use to the exclusion of the others. Of course, in individual cases under particular circumstances, it may be demonstrated why a specific method of allocation is superior to alternatives or should be used to the exclusion of all others. This has not been demonstrated here; and the burden of doing so was on complaint counsel. All that the parties have done is to advance general reasons, not related to the specifics of this case, why one method should be preferable to another. All of these reasons ostensibly have been advanced to and considered by CASB (as well by the National Industrial Conference Board) and that board has seen fit to issue general guide lines which, in my opinion, allow all of the methods of allocation advocated by the various parties here.

715. Under these circumstances, there is a lack of proof that the allocations advocated and introduced by respondents are improper; and respondents are entitled to have those allocations utilized in arriving at accounting rates of return for their RTE cereal businesses. These allocations, in turn, are the ones to be used in Dr. Stauffer's formula for arriving at economic rates of return.

More detailed findings covering the several allocation methodologies of the different parties follow.

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[72] This formula could not be used here because of insufficient payroll and tangible asset data. In any event, sales dollars is recognized by CASB as having a controlling impact.

Dr. Mellman's Method
(The Method Contended For By Complaint Counsel)

716. Dr. Mellman did not reallocate costs and expenses, or assets and liabilities, where the RTE cereal company's original assignment was direct and not allocated, because there can be no improvement on a direct assignment (Tr. 20,169). Thus, for example, advertising expenses were not reallocated because advertising was charged directly to the brand for which the advertisements were run.

717. Dr. Mellman recognized that to determine the profits of a business segment, such as the RTE cereal segment of a diversified corporation, an effort basis is the best way to allocate expenses to segments where the information is available; that expenses should be allocated in proportion to how efforts were actually applied, because it reflects the way resources were used by that segment; and that effort can be measured on a number of different bases. For example, in allocating such expenses as the salary of a division manager who is responsible for products in more than one segment, an effort basis might allocate the associated expenses according to the amount of time spent in supervising the segments under his control. **[204]**Thus, if the manager spends 40% of his time supervising one of two segments, 40% of the expenses associated with the manager, such as his salary, would be allocated to that segment (Tr. 20,158–60). Respondents would agree with Dr. Mellman up to this point.

718. When detailed data on effort are unavailable, an alternative basis of allocation must be used. Dr. Mellman was of the opinion that the most reasonable approximation of an effort basis, in the absence of detailed information on effort, is generally cost (Tr. 20,158, 20,164). The cost basis allocates expenses to the segments in the same ratio as direct expenses have been incurred by those segments (Tr. 20,161).

719. An example would be a division manager supervising two segments, A and B, and the absence of records which show the actual time spent (the actual effort) supervising the two segments. Assume that 40% of the total direct costs of activities managed by the division manager are generated by segment A. These costs include materials used, labor, overhead, marketing costs, promotions, selling expenses, and so forth. In the absence of detailed information on the time spent working on each segment, 40% of the division manager's cost would be allocated by Dr. Mellman to segment A. The assumption underlying this method of allocation is that the division manager would allot his time in accordance with the relative

activities of segments and the 40% share of costs attributed to segment A would reflect its share of total activity supervised by the division manager (Tr. 20,161–62).

720. Professor Mellman also used a cost basis to allocate assets and liabilities. He recognized that, ideally, allocations of assets would be based on actual usage of the assets allocated. Thus, for example, a warehouse might be allocated based on the square feet of space used by each segment. However, such a basis would require detailed information about the way in which an asset was actually used (Tr. 20,167). In the absence of such detailed information, Dr. Mellman used a cost basis for the same reasons he used a cost basis for allocations of expenses. In the illustrative example of the division manager, the assets such as the office used by the division manager would be allocated in the same proportions as his expenses. Thus, if 40% of his expenses were assigned to segment A, 40% of the assets he used would be assigned to the segment (Tr. 20,167–68).

721. Applying the same principles, a cost basis was used in the assignment of liabilities, whereunder liabilities are allocated according to ratios of the expenses related to that liability. For the division manager described above, there would be a liability shown on the company's books for salary owed to him but not yet paid. Under a cost principle, that liability would be allocated in the way in which the division manager's costs were allocated, inasmuch as liabilities are costs and expenses that are incurred but not yet paid (Tr. 20,169–70).

722. Of course, division costs do not necessarily reflect corporate activity and the utilization of corporate assets. **[205]**Relatively costly modern equipment may relieve the division manager of time consuming exercise of responsibility, and the cost may not at all reflect the share of warehouse space occupied.

723. The cost of effort or activity that is to be allocated is that at the corporate level, not at the division level. No necessary relationship exists between expenses at the corporate level and costs at the division level. The two levels involve different groups of people doing different things (Tr. 35,907–15).

724. Costs at the division level include outlays for raw materials. At General Mills, for example, roughly 75% of the costs of RTE cereal sales were ingredient costs (Tr. 18,272). Changes in the price or composition of raw materials are unrelated to changes at the corporate level. Depreciation is a significant cost item at the division level. There is no plant and equipment at the corporate level (Tr. 35,912–13).

725. Executive incentive payments are an item of unallocated

corporate expense. Such costs are inversely related to operating costs such as manufacturing, distribution and marketing inasmuch as the amount of executive incentive payments increases with the amount of corporate profits. Thus, as costs rise, profits decline and incentive payments would decline (Tr. 18,267, 18,269, 18,342–43).

726. Professor Mellman allocated cash and marketable securities on the basis of total segment operating costs plus interest, taxes and unallocated corporate expense, on the gound that cash is used to pay for costs and expenses (Tr. 20,549, 20,799–803). However, cash and marketable securities, as they appear on the General Mills balance sheet as of the end of its fiscal year, for example, are a function primarily of profits. They would appear to be inversely related to costs inasmuch as the higher the costs, the lower the cash on hand and the cash temporarily placed in short-term marketable securities (Tr. 18,326, 35,920–22).

727. Application of Dr. Mellman's costs basis allocation formula resulted in a range of General Mills' ratio of allocation of from 10% to 18% from year to year (Tr. 20,794–97), a substantial variation without apparent explanation. It would also result in an exceptionally low ratio between current assets and current liabilities for General Mills' RET cereal segment. This is one measure of the financial soundness of a firm. Professor Mellman allocation so little of the unallocated corporate assets to General Mills' RTE segment that the segment has an average current ratio of only 1.4 for the period 1958–1972 and only 1.0 in 1965, 1.2 in 1971 and 1.1 in 1972 (Tr. 20,925–30; GMX 58, 472). These General Mills ratios are substantially lower than those for Kellogg, General Foods, Quaker and the Internal Revenue Service group of manufacturing firms which compliant counsel use as a profit "benchmark." Indeed, the General Mills ratios are lower than the ratio for the firms in the IRS sample that suffered net earning losses (GMX 58, 472). Such ratios would be unrealistic for a General Mills RTE cereal segment which is alleged by complaint counsel to have been very profitable (Tr. 35,111). In addition, Dr. Mellman's allocation to RTE cereal of **[206]** General Mills' corporate unallocated expenses decreased by one-third from 1967 to 1972 despite the fact that sales and profits increased by 30% (Tr. 21,110).

728. The above analysis of a cost allocation approach and its application to General Mills' and General Foods' operations indicates why such a method of allocation cannot be found to be the only or a superior method of allocation to be utilized in this case. Dr. Mellman has conceded that his cost allocations may well vary from

what an actual measurement of the breakdown of a joint effort might show (Tr. 20,893, 20,905, 21,524).

General Mills' Method of Allocation

729. General Mills' expert, Mr. Troxel, used profits as the primary basis for allocation (Tr. 18,266–72, 18,302–05, 18,325–26, 18,342–43), although some items were allocated on the basis of sales (Tr. 20,830–33; CX–GM 2486). As previously indicated, there does appear to be a causal relationship between profits and incentive payments since incentive payments are normally based on profits (Tr. 18,266–67, 18,269, 18,342–43, 35,909). The same causal relationship appears to exist between profits and cash and marketable securities (Tr. 18,325–26, 35,920–22). Inasmuch as taxes are a direct result of profits, the allocation of accrued taxes on a profit basis also appears appropriate (Tr. 18,323).

730. Just as with Dr. Mellman's cost basis of allocation, Mr. Troxel's profit-sales basis has its obvious failings. Since sales figures include an element of profit, allocations based on sales reflect, in part, a segment's ability to bear costs rather than the effort or resources expended. Furthermore, there are numerous factors that affect selling price, and there is not necessarily a relationship between selling price and cost or usage (Tr. 20,164–65).

731. For reasons similar to those applicable to allocations based on sales dollars, a profit basis reflects the ability of a segment to pay or bear the allocated costs, rather than effort or activity (Tr. 20,165). The most obvious failing of a profit margin basis of allocation, however, is that, if a segment has zero profits, it would get no allocation of corporate expense; and if it had a loss, it would actually receive a negative allocation, despite the fact that corporate headquarters might have been devoting an inordinate amount of work in an effort to turn the unprofitable segment around (Tr. 20,166, 20,168–69). Further, a profit basis of allocation would result in allocation revisions reflecting changes in profits, irrespective of the flow of services (Tr. 20,793).[73] **[207]**

732. Nevertheless, sales and profit bases of allocation are acceptable under statements issued by the Commission's Bureau of Economics and under CASB standards, and are no less acceptable than the cost basis utilized by Dr. Mellman.

733. Further, in the Bureau of Economics' staff memorandum attached to the Commission's Supporting Statement to its 1974 Line

[73] The lack of complete reliability of a profit basis of allocation is thus demonstrated; and it is immaterial that no segment of General Mills showed a loss on the basis of a five-year moving average of profits (Tr. 35,927–29).

of Business reporting form, it was stated "that the reporting companies are in a better position than the FTC staff or anyone else to make them [allocations]" (at p. 5). Normally, substantial weight would be given to allocation procedures if they were utilitzed by a company in the normal course of its business. While the allocations relied upon by General Mills were prepared by an outside consultant for purposes of this case (Tr. 18,150), they are nevertheless entitled to the same presumptions of correctness they would be entitled to in Line of Business reporting.

General Foods' Method of Allocation

734. General Foods' established cost accounting system assigned any expense or revenue that could be directly identified with a particular product or brand directly to that product or brand. Residuals were allocated based on formulas prescribed throughout the corporation. Within divisions that contained homogeneous units, the allocations were based on unit sales. Where not homogeneous, the residual was normally allocated on the basis of a fifty-fifty average of unit sales and gross dollar sales (Tr. 16,277, 16,333, 38,020).

735. The figures used were taken from the basic accounting records of General Foods, used by it for operations and decisionmaking purposes in the regular course of its business. The basic data was not prepared for purposes of this litigation. Existing records were utilized and methodologies used by General Foods in the ordinary course of its business were employed (Tr. 16,230, 38,016–17).

736. Under the previous discussion of criteria for an allocation system, General Foods' method certainly qualifies as an acceptable method and there is no reason to believe that any alternative method would be preferable (Tr. 37,924–32, 38,016–17).

737. Not only does the presumption of preferability for a company's own method of allocation apply, as stated in the Bureau of Economics' staff memorandum accompanying the Line of Business reporting form, but General Foods' method was one used in the regular course of business and so is entitled to the presumptions normally accorded such business procedures.

738. General Foods' cost accounting system has already been the subject of hearings *In the Matter of General Foods Corporation,* Docket No. 9085. In that case, Professor John Dearden, a professor of accounting at the Harvard Business School, was called as an expert witness by complaint counsel (Tr. 38,021–22). In analyzing profit **[208]**calculations, Professor Dearden reviewed General Foods' ac-

counting and financial manuals and concluded that General Foods has an excellent cost accounting system and that there was nothing he would, as a cost accountant, want to change (Tr. 38,023–24; GFX 1332Z–10, Z–11, Z–131).

739. Professor Dearden's opinion was that General Foods' allocation procedures, while a matter of judgment, were "not capricious"; that they constitute a good and sound way of making allocations; and that there is no better way (Tr. 38,025–26; GFX 1332Z–220, Z–221).

740. Thus, General Foods' cost accounting system has been presented by the Commission's staff as highly reliable in the other case involving General Foods. Complaint counsel cannot merely turn their backs on this position.

741. Complaint counsel (CRPF 11–28, 11–29) agrue that Professor Dearden's testimony in Docket 9085 should be limited to General Foods' Maxwell House Division which was directly involved in that case; that "[i]f Professor Dearden had testified in the RTE cereal case, he might have explained that there are differences in the situations that make his testimony in the 'Coffee' case inapplicable to the RTE cereal case." An examination of Professor Dearden's testimony, however, indicates that his commendation of General Mills' cost accounting system went to the system as a whole and was not inapplicable to RTE cereals. If complaint counsel were of the opinion that Professor Dearden would have limited and distinguished his testimony had he testified in this case, it was complaint counsel's obligation to have called him as a rebuttal witness. They did not.

Respondents assert (GFPF 5–70, 5–71, 5–85 thru 5–128; KPF 5–92, 5–93; GMPF 3–51) that Dr. Mellman has made a number of errors in applying his allocation formula. These assertions include alleged utilization of allocation ratios when direct assignments were possible, utilization of improper and inconsistent ratios, improper "grossing-up" from segment figures to corporate figures, improper and unsupported assumptions and failure to make certain adjustments. Complaint counsel (CRPF 11–38 thru 11-42) defend Dr. Mellman's "grossing-up procedure" as reasonable, and otherwise purport to justify Dr. Mellman's procedures. Apparent errors are asserted to be insignificant (CRPF 11–43 thru 11-59).

Inasmuch as respondents are entitled to rely on the more favorable allocation procedures utilized by General Mills and General Foods, it would serve no purpose to resolve the numerous issues raised regarding alleged errors in application of Dr. Mellman's methodology. Complaint counsel make no claim that General Mills'

or General Foods' computations are not in accord with their respective methodologies or contain any errors.

742. In summary, each of the allocation procedures proposed in this case provides a rough approximation of how joint costs ought to **[209]**be assigned to the RTE segments of General Mills' and General Foods' overall businesses. And each is subject to the possibility of a degree of error. Each method falls within accepted accounting procedures and, in the absence of a showing that the methodology advocated by complaint counsel is superior for purposes of this case to those followed by General Mills and General Foods, the parties are entitled to rely upon the procedures most favorable to them. This is particularly true in the case of General Foods where the procedure has been followed in the normal course of its business.[74]

(b) Cash Flow Profile

743. A second critical element of Dr. Stauffer's formula is the cash flow profile. The formula relates the investment in plant, property and equipment to the associated cash flow generated by that investment. Cash flow equals the gross receipts that are associated with a product produced using the plant, property and equipment. From such receipts, costs such as labor, raw material, and supplies are subtracted. Thus, cash flow is the net money flowing in and does not include deductions for depreciation, research and development, or advertising which reflect outlays of cash for investment, not deductions from return on investment. Net income would equal cash flow minus these additional items and taxes (Tr. 19,354, 19,394, 37,499–500).

744. As previously explained (Findings 702–03), a rectangular cash flow profile assumes that the cash flow produced by an asset is the same for each year of the life of the asset; and a triangular cash flow profile assumes that the cash flow produced by an asset starts at a high level and declines steadily over the life of the asset. Inasmuch as cash flow data is not readily available, the profile of the flow had to be assumed. In the absence of actual knowledge, Dr. Stauffer applied his formula utilizing two alternative profile assumptions (rectangular and triangular) in order to establish lower and upper bounds of economic return.[75] Dr. Stauffer made no effort to

[74] Of course, it would be preferable to have General Mills' and General Foods' joint costs allocated by the same method, which is not the case, except for complaint counsel's cost method of allocation. But, inasmuch as the cost method may not be imposed, we are left with General Mills' and General Foods' joint costs being allocated by different methods.

[75] Kellogg's witness, Dr. Solomon, agreed that, in the absence of actual data, it is appropriate to work with two outside extreme assumptions with the further assumption that the correct answer lies somewhere in between (Tr. 31,216).

determine the true profile. The two profiles used were merely assumptions to establish bounds within [210]which the true profile would lie. Dr. Stauffer was of the opinion that in the real world, the result would lie somewhere between the rectangular and triangular extremes, but that he could not be more specific than that (Tr. 19,386–87, 19,395–97, 25,074).

745. The economic rate of return calculations may be affected significantly by the choice of cash flow profile (Tr. 19,394, 38,186). Each respondent has a substantially higher economic rate of return under Dr. Stauffer's formula when a triangular cash flow profile is used than when a rectangular cash flow profile is used (Tr. 38,051; CX 701Z–21, Z–22; GFX 1368).

746. Under circumstances where the rectangular cash flow profile or lower bound is a distinct possibility, I am precluded from applying against respondents any cash flow profile assumption which would result in the computation of higher economic rates of return. As detailed below, complaint counsel have failed to establish that the rectangular cash flow profile may not be a reasonable approximation of the cash flow experienced by respondents and others in the RTE cereal industry. Therefore, I shall not consider and apply against respondents any Stauffer type computation of economic rate of return which does not embody a rectangular cash flow profile.

747. Complaint counsel assert (CPF 11–84 thru 11–87; CRPF 11–103) that a declining cash flow profile "close to the triangular profile" or "closer to the triangular than the rectangular profile" is the appropriate cash flow profile to use in computing the RTE cereal companies' rates of return. This position, however, does not indicate just how close to the triangular the true profile is alleged to be. Complaint counsel ground their position on the general assumptions (1) that as assets age, the costs of maintenance increase and there are longer periods of downtimes, (2) as assets age, they tend to become obsolete as newer and more efficient equipment becomes available and older assets are placed on partial use or standby status, and (3) since a firm has a variety of assets with differing lifetimes, depiction of each asset by a box, with the shortest box on top followed by each longer box below with the longest box on the bottom, would result in a triangular diagram.

748. The cash flow profile varies from industry to industry and individual industry assessments are required to attribute specific profiles to particular industries. (Tr. 20,000, 20,029, 31,207–09, 31,215–21; CX 703A). Complaint counsel have made no such assessment for the RTE cereal industry, but rely primarily on the

testimony of Dr. Stauffer. Dr. Stauffer, however, had made no study of the cash flow in the RTE cereal industry and had no specific familiarity with the industry (Tr. 19,051, 19,993). In any event, Dr. Stauffer did not testify that the true profile would be "close" to the triangular profile, only that, in his opinion, the actual profile would be closer to the triangular rather than the rectangular profile (Tr. 19,592). And this opinion was based on his intuition, not on any study of the industry (Tr. 19,395, 19,592). Dr. Stauffer's intuitive expectations were based upon the same general considerations asserted by complaint counsel—that output would **[211]**decline as assets aged and became obsolete and that there would be increased maintenance costs (Tr. 19,395, 24,954–55).

749. However, there is no record evidence to support Dr. Stauffer's theory; and the record evidence tends to refute it.

750. The RTE cereal industry involves sufficiently complex processes that productivity increases over time and costs decrease due to the learning curve phenomenon. People learn to do their jobs better and engineering personnel find and remove bottlenecks (Tr. 24,963–65, 27,235–36, 27,289, 28,147, 31,252, 33,018–19, 36,664–70, 38,064–65, 38,483–84). For example, newer plants of Ralston had lower yields and greater production problems than older plants because of lesser personnel experience (Tr. 10,693, 10,723, 10,742–43, 10,755–56, 17,561); and Kellogg upped its production capability with respect to Product 19 by overcoming various production problems over time and because of the increase in efficiency over time of its personnel (Tr. 29,341–58, 29,364).

751. Maintenance costs for General Foods are highest during the start-up period of a new product manufacturing line. Thereafter, through an extensive preventive maintenance program, maintenance costs are lowered over the life of a project. The number of unscheduled break-downs are reduced and the durability of replacement parts is increased so that periods between planned maintenance shutdowns are lengthened (Tr. 36,677–87). Kellogg's equipment is also durable and requires little in the way of maintenance (Tr. 29,439). Its preventive maintenance program decreases the number of breakdowns and smooths out operations over time (Tr. 35,670–71, 35,685).

752. General Foods is often able to increase productivity and decrease unit production costs over the life of its assets. The components of a production process normally have differing capacities. By finding ways, usually with little or no additional investment, to increase the capacity of the limiting component, the capacity of the entire line can be increased. Production is also increased and

costs decreased through direct application of sophisticated engineering techniques (Tr. 36,665–70).

753. General Foods' production equipment is long lived. For example, ovens installed in 1927 to bake Grape-Nuts are still being used efficiently today, in part because of the regular upgrading of equipment that accompanies preventive maintenance (Tr. 36,686–87). Rather than finding that its older equipment was obsolete, General Foods found, in planning its Modesto facility, that duplicating its Battle Creek equipment would provide it with the most current technology (Tr. 36,690–91).

754. In any event, obsolescence is primarily a matter of longevity of assets, another aspect of Dr. Stauffer's formula. When an asset is retired because of obsolescence, this does not impact the cash flow during the life of the asset. **[212]**

755. To the extent that sales increase over time, cash flow would increase (Tr. 31,209). In an article in *Drug Development and Marketing,* published in 1973 or 1974, entitled "Profitability Measures in the Pharmaceutical Industry," Dr. Stauffer described the process of choosing an appropriate profile for use in computing the profitability of the pharmaceutical industry. Dr. Stauffer plotted the gross sales of successful pharmaceutical products and observed a product life-cycle profile with sales rising, then level and finally declining (Tr. 38,098–99).

756. It was Dr. Stauffer's opinion, expressed in this published work, that this product life cycle profile could produce an economic rate of return lower than that obtained by using a rectangular profile. Dr. Stauffer used a rectangular profile for his analysis of the pharmaceutical industry, explicitly recognizing that its use could overstate the economic rate of return (Tr. 19,990–91, 38,099).

757. Products accounting for over 50% of total RTE sales of General Foods and Kellogg enjoyed increased sales over time (Tr. 31,246–51, 38,101–04; GFX 1360). Productivity of equipment is increased as demand increases (Tr. 36,662–64). As in the pharmaceutical industry, this would indicate that the cash flow profile for the RTE cereal industry was at least rectangular, if not rising ramp, which would result in an even lower accounting rate of return (Tr. 31,246–47, 38,099, 38,105–08).

758. To the extent cash flow would have declined due to any rising costs, it is to be expected that respondents would have raised prices. Further, the extent of inflation over the period would have moved even a triangular cash flow profile toward the rectangular (Tr. 31,233–35, 38,482).

759. The purpose of Dr. Stauffer's formula is to correct the extent

to which the accounting rate of return overstates the economic rate of return (Tr. 19,360, 19,987). Yet, when a triangular cash flow profile is used in the formula with a rapid decay rate of advertising,[76] the result is an economic rate of return higher than the accounting rate of return (Tr. 38,081–83; GFX 1358). Further, with a triangular cash flow profile in Dr. Stauffer's formula, a firm would continue to invest heavily in advertising despite a negative cash flow over the last several years of the life of the investment (Tr. 34,782–87, 34,790–91, 34,864–65, 37,782–87, 38,092–97; GFX 1357; GMX 456). One would not expect a firm to continue to produce and heavily advertise an RTE cereal product for years while it continued to lose money.

760. As previously noted, complaint counsel contend (CPF 11–87) that, since the plotting on top of each other of blocks of varying **[213]** lengths depicting the different length of lives of different assets forms a declining triangular shape, the overall profile for the company must be triangular. This contention has no merit. What complaint counsel are arguing, contrary to the basic testimony of Dr. Stauffer, his original dissertation and his pharmaceutical study, and the testimony of all of the other experts who testified in this case, that there is no such thing as a rectangular cash flow profile. For every firm has assets of varying longevity and every firm's assets could be depicted in the triangular fashion relied upon by complaint counsel.

761. The manner in which Dr. Stauffer defines cash flow profile for use in his formula has nothing to do with the triangular depiction of different lived assets. If the individual underlying assets produce rectangular cash flows, it is immaterial how you stack one on top of the other by depicting boxes so that they come out in a triangular fashion. So long as the individual underlying assets produce rectangular cash flows, Dr. Stauffer's formula must use a rectangular cash flow profile (Tr. 35,146–47).

762. The overall economic rate of return for a firm is the result of the returns earned by each of its investments. If each investment (whether the same or of unequal life) earns at a rate of 5%, the company overall earns at a rate of 5%. If each investment earns its 5% through a rectangular cash flow, a rectangular cash flow profile is the appropriate profile to characterize the firm as a whole (Tr. 35,146–47).

763. To demonstrate this point, Dr. Troxel created a hypothetical firm with investments of different lives. Each was given a rectangu-

[76] This relates to the advertising correction which will be considered below.

lar cash flow profile resulting in an economic rate of return of 10%. Thus, the company in total would show a 10% economic rate of return. The data on the firm were inserted into Dr. Stauffer's model using, alternatively, a rectangular and triangular cash flow assumption. Only the formula using the rectangular assumption produced the known correct answer of 10%. The formula using the triangular assumption computed a return of 12.3% (Tr. 35,127–49; GMX 463).

764. As Dr. Fox has explained, if a project has necessary components of differing lives, the entire process would stop and cash flow would fall to zero as soon as the shortest-lived asset gave out. The project would then have a rectangular profile with a service life equal to that of the shortest-lived asset. If, instead of allowing the project to die, the shorter-lived assets were replaced over the life of the longest-lived asset then, graphically, there would be a series of short boxes on top, a series of longer boxes on the next level and so forth; and the sum of the profiles would be rectangular (Tr. 38,075–77).

765. Complaint counsel, in their March 1976 trial brief and in their July 1976 revised trial brief, took the position that the appropriate cash flow profile in this case was rectangular (GFX 21, **[214]**22A–C). This obviously reflected the position at that time of complaint counsel's expert in the matter, Dr. Stauffer. At his April 1976 disposition, Dr. Stauffer took the same position. He said, "I decided early on to use a constant [rectangular] cash flow" instead of other profiles (Tr. 25,088–89, 25,231); that "there are sound reasons for using the rectangular profile" (Tr. 25,091). He explained that the "real" profile (CX 702D) was most likely to have a product life cycle shape, *i.e.,* one which rises gradually, plateaus and then declines gradually (Tr. 19,395–96, 25,114). He had run an "extensive series of simulations" and had found that the estimates using the product life cycle profile were "very close to the result obtained using a rectangular profile" (Tr. 25,095–98). He rejected the triangular profile. The assumption associated with a triangular cash flow profile that cash flow "rises rapidly" and then "dwindles away quickly" was not "empirically accurate" (Tr. 25,230–31). In estimating economic profits for the drug industry, Dr. Stauffer had used the rectangular profile assumption as a proxy for the "real product life cycle profile" (Tr. 19,988–90). He concluded that "the rectangular profile is, broadly speaking, appropriate" (Tr. 25,096). He also testified at the April 1976 deposition that his work in computing economic rates of return was completed (Tr. 25,227).

766. I read Dr. Stauffer's deposition testimony, given in April 1976, as unequivocally expressing his opinion that the rectangular

cash flow profile is the appropriate one for use in this case. Having read his testimony in hearings in October 1977, I fail to find any reasonable basis for accepting his later opinion in lieu of that previously given. Dr. Stauffer's original considered opinion as to the appropriateness of the rectangular cash flow profile is joined in by economic experts, Dr. Fox and Dr. Markham (Tr. 38,108, 38,482, 38,484).

767. While respondents have advanced arguments in support of using a rising ramp profile (KPF 5–112, 5–113, 5–128; GMPF 3–68; GFPF 5–224), which would result in lower economic rates of return than by using the rectangular, respondents' uniform position is that a rectangular cash flow profile is appropriate (KPF 5–114, 5–127, 5–128; GFPF 5–153, 5–160; GMPF 3–75, 3–76). On the basis of all of the evidence recited above, it is concluded that complaint counsel have failed to establish that any cash flow profile less favorable to respondents' position than a rectangular one may be utilized.

(c) The Advertising Adjustment

768. A third critical input into Dr. Stauffer's formula is the advertising decay rate. As previously explained, accountants treat all advertising as current expense even though it may benefit future years' incomes. To the extent that advertising generates sales in future years, an adjustment must be made in order to arrive at the true or economic rate of return. The rate at which past advertising continues to benefit sales is its persistence. Correspondingly, the **[215]**rate at which its benefit falls off is termed the decay rate.[77] Inasmuch as advertising expenditures are very high in the RTE cereal industry, the expensing of advertising substantially overstates the true or economic rate of return and the advertising adjustment is very important.

769. As part of his overall formula for computing economic rates of return, Dr. Stauffer incorporated what is known as the Koyck model to account for how the effects of advertising wear off over time (Tr. 19,415, 22,169–70).

770. The Koyck model assumes that the effects of advertising wear off at the same percentage rate each year. This percentage is known as the advertising decay rate (Tr. 19,416–18, 22,310–11; CX 702F). A decay rate of 80%, for example, means that if advertising generates $100 of sales in year one, the sales generated by the original advertising will have worn off or decayed to $20 in year two

[77] The decay rate can be viewed as a proxy for decay in the intangible asset, goodwill. Advertising is viewed as an investment in goodwill (Tr. 22,313).

and the sales will once again be 80% lower in year three than in year two, or $4.

771. The Koyck model has been used extensively in the economic literature to represent the relationship between advertising and sales. Virtually all studies that have adjusted profitability to take account of the advertising bias have employed the Koyck model (Tr. 19,415, 22,170–71). Dr. Stauffer obviously used the Koyck model for lack of anything else, for his opinion of the model, previously stated in his pharmaceutical study and reaffirmed at this hearing, is as follows (Tr. 19,988–89, 24,989–90):

> The assumed functional relation between sales and advertising, while plausible in its general features, is clearly *grossly oversimplified,* if not *arbitrary,* although it has been widely used in other economic analyses. That choice has been included faute de mieux in the detailed mathematical model described in the appendix with *no allusion as to its accuracy.* The contribution of advertising to the rate of return discrepancies for the [pharmaceutical] cases analyzed here is modest. So the overall conclusions are not affected by *the imprecision in the economic description of advertising.* It is useful to include even *this crude model* for sales response to advertising in order to better illustrate the direction of the necessary corrections, but it is important to note the caveat that in other applications *where advertising places a more* **[216]***important role in the financial results, the estimates for the real rates of return might prove quite sensitive to the particular specification of the advertising sales response function* (emphasis supplied).[78]

Here, of course, advertising plays a most important role in the financial results.

772. While widely used in economic literature and studies, it is highly questionable whether the Koyck model provides a sufficient degree of precision to permit an adjudication of facts in a litigated matter where the proposed remedy is to require the respondents to divest themselves of assets and offer royalty-free trademark licenses of their remaining products. Nevertheless, since the Koyck model is an element in converting accounting rates of return into more accurate economic rates of return, I shall continue to consider Dr. Stauffer's conversion formula, including the Koyck model.

773. Because of the admitted imprecision of the Koyck model, however, which in large part flows from the difficulty in selecting an appropriate decay rate, I am compelled to accept the lowest rate (the one most favorable to respondents' position) which appears to be possibly correct.

774. While Dr. Stauffer used his own formula, which incorporated the Koyck model, he used alternative advertising decay rates of 35% and 80% which were estimated as lower and upper bounds by

[78] Dr. Butters has described the Koyck model as extremely rough and imperfect (Tr. 37,636).

Dr. Schmalensee and Mr. Glassman (Tr. 19,420; CX 701Z–21–Z–25). Dr. Schmalensee had the primary responsibility to develop decay rates for purposes of presenting complaint counsel's case. Mr. Glassman relied upon the same data Dr. Schmalensee relied upon in reaching similar conclusions.

775. Dr. Schmalensee and Mr. Glassman relied in part upon several published economic studies for their estimates of the advertising decay rate for RTE cereals (Tr. 22,172–77, 26,135–38). Professors Parsons and Bass studied the effects of advertising on sales[79] (said by Dr. Schmalensee to be Kellogg's Corn Flakes and Sugar Frosted Flakes). Their analysis indicates that they believed the advertising decay rate for these brands to approximate 80% (Tr. 22,173, 26,135–36). Professor Darrel Clark, in an article which **[217]** surveyed more than 70 studies of the decay rate of advertising,[80] concluded that the decay rate for advertising is very rapid, approximately 90% per year (Tr. 22,176–77, 26,137–38, 37,787). Professor Ayanian estimated that the advertising decay rate for RTE cereals was 35%.[81]

776. Dr. Schmalensee testified (Tr. 22,176) that the Parsons and Bass study appeared to be a sound piece of work; that it used modern econometric figures with monthly data and, on the basis of methodology, was superior to the Ayanian paper. However, neither Dr. Schmalensee nor any other witness called by complaint counsel described the methodology used by any of the studies relied upon. No indication was given as to the supposed preciseness of the estimates.

777. The only witness who testified as to the methodology utilized in the studies relied upon by Dr. Schmalensee and Mr. Glassman was Dr. Butters. Dr. Butters testified that, whereas the Koyck model purports to utilize a decay rate on total sales, the literature relied upon by Dr. Schmalensee and Mr. Glassman does not reflect calculations of decay rates on total sales, but only on marginal sales (Tr. 37,652–54, 37,663–64).

778. The literature dealt with on-going products and thus was based on data involving relatively small changes in advertising from one period to the next, as opposed to data involving cessation or drastic reductions in advertising. Since the analyses included in the articles showed only the sales effect of small or "marginal" changes

[79] Frank M. Bass and Leonard J. Parsons, "Simultaneous-Equation Regression Analysis of Sales and Advertising," *Applied Economics*, 1969, pp. 103–24.

[80] Darrel Clark, "Econometric Measurement of the Duration of Advertising Effect on Sales," *Journal of Marketing Research*, November 1976, pp. 345–57.

[81] Robert Ayanian, "Advertising and Rates of Return," *Journal of Law and Economics*, October 1975, pp. 479–506.

in advertising, the decay rate literature analyzed only the impact on marginal sales (Tr. 37,642–43).

779. Since marginal sales (the increase in sales associated with a modest increase in adverising over a pre-existing level) would be, to a large degree, the result of "whim" purchases, rather than from the core of loyal users, such sales could be expected to decline more rapidly once advertising returned to its pre-existing level. It is more likely that marginal units of advertising would attract additional sales which, when the marginal units of advertising are withdrawn, would decay more rapidly than the rate for all sales (Tr. 37,647, 37,664).

780. The decay rate literature, which measures only the decay rate on marginal sales, is not useful for estimating a decay rate on total sales. A biased estimate results from this literature, because, for use in Dr. Stauffer's advertising term, it is not **[218]**measuring the right thing (Tr. 37,642–65). The measurement of the decay rate on marginal sales fails to measure the level of continuation of all sales if all advertising were stopped.

781. Complaint counsel assert (CRPF 11–147, 11–148) that the studies in question purported to measure the total decay rate on advertising, not marginal rates. Irrespective of what was purported to have been studied, Dr. Butters was the only witness who described what in fact was considered. And his testimony, which is unrebutted, clearly establishes that the studies were limited to analyses of marginal decay rates.

782. In addition to the economic articles on decay rates, Dr. Schmalensee and Mr. Glassman relied upon a study conducted by Dr. Schmalensee of RTE cereal brands which had had all advertising support withdrawn. Initially, Dr. Schmalensee calculated decay rates for seven products for which advertising was withdrawn and the products were subsequently withdrawn from the market prior to December 1972, the end of the time period he examined. Subsequently, Dr. Schmalensee added four products to his study for which advertising had been cut off, but which had not been withdrawn from the market as of December 1972 (Tr. 37,666–67; GFX 1329, 1330). Dr. Butters located and caused decay rates to be calculated for an additional five products which were still in national distribution as of December 1972 (Tr. 37,676–83; GFX 1329).

783. The mean decay rates expressed in percentages for the 16 products so selected are as follows:

Products in National Distribution	%	Products Withdrawn From Distribution	%
Puffa Puffa Rice	41	Puffed Corn Flakes	58
Concentrate	- 1	Corn Flakes w/Strawberries	38
Pep	6	Corn Flakes w/Blueberries	65
Krumbles	- 4	Bran & Prune Flakes	20
Grape Nuts Flakes	- 3	Clackers	76
Krispy Critters	8	(All) Stars	36
Treat Pak	- 2	OK's	31
Muffets	5		
Sugar Jets	42		

784. Two facts immediately stand out: (1) There is a tremendous variation in decay rates among products; and (2) Products which were withdrawn from national distribution prior to December 1972 generally had a much higher decay rate than those which remained in distribution after that date.

785. Among products remaining in national distribution, the variation in decay rates ranged from -2% to 42%; and for products withdrawn from distribution, the decay rates ranged from 23% to 76%. **[219]**

786. The negative decay rates for four of the products are plausible because market growth or a shift in consumer tastes can lead to increased sales even without advertising. Also, sales of some brands may be influenced by advertising for related brands. For example, sales of Grape Nuts Flakes may be affected by advertising for Grape Nuts (Tr. 37,685–86).

787. Brands differ in decay rates depending upon a number of factors, including the quality of the product. Other factors could include the length of time the product had been advertised, the amount of advertising of competing products, as well as institutional advertising or overall RTE cereal advertising by the company owning the brand in question. There is no single best way to arrive at a single number reflecting the various differing figures (Tr. 23,307–08, 26,574–77, 37,637–39).

788. The first seven brands selected by Dr. Schmalensee were withdrawn from the market by 1972. This indicates that they were failures in the marketplace and that their sales decay was not so much related to the withdrawal of advertising as to the fact they were failing brands. Also, a large part of the decay may have been due to a loss in distribution, not to a decision of consumers not to buy the product (Tr. 37,674–75). The other nine brands, while having greater consumer acceptance, as reflected by the fact they were not withdrawn from the market, were still not typically successful

brands. Otherwise, advertising support would not have been withdrawn (Tr. 37,676).

789. The large majority of advertising is associated with RTE cereals which have been successful and have been nationally advertised and consumed for 10, 20, or 30 or more years (GFX 1319). The 11 products studied by Dr. Schmalensee, by and large, had been nationally advertised for much shorter periods, but the decay rates were lower for those products which had been advertised over a longer period of time (Schmalansee, "Revised Estimates of Annual Advertising Decay Rates Based on Sales of RTE Cereal Brands with Advertising Withdrawn," Paper Presented for the FTC Bureau of Economics, April 1977, p. 4 (Table 2)) (GFX 1318; KX 25; CX–K 680C). So again, the products studied were not those typically associated with prolonged advertising. However, for brands on the market for a considerable period of time for which advertising support had been withdrawn, the decay rates were low, ranging from .005 to .14 (Tr. 23,310–11).

790. Of the nine brands which had greater consumer acceptance and less of a failing product bias, as reflected by the fact they were kept in national distribution, seven had advertising decay rates below 10%, and all but one rate were substantially below that figure.

791. The evidence, therefore, does not support Dr. Schmalensee's and Mr. Glassman's conclusions (Tr. 22,171–73, 22,177–79, 22,316–23, 26,136–38; GFX 1329, 1330) that the upper and lower bounds for the decay rate were 80% and 35%, respectively, and more likely to be closer to 80% than 35%. On the other hand, Dr. Butters' estimate (Tr. 37,687) that the decay rate could be as low as 10% is not **[220]** unreasonable in light of the studies made of individual RTE cereal products where advertising was discontinued, but the products remained in distribution beyond 1972. As explained above, I am required not to apply any decay rate higher than the lowest rate which appears to have a reasonable possibility of being correct.

3. *Extent To Which Rates Of Return Have Been Established*

792. Applying Dr. Stauffer's formula and utilizing a rectangular profile and a 10% decay rate for each of the respondents, together with General Mills' and General Foods' methods of allocating joint accounting data to their RTE cereal business segments, the following economic rates of return are arrived at:

	Kellogg	General Mills	General Foods
1958–1970	11.7	10.5	7.3
1954–1972	13.2	10.1	6.7

(CX 701Z–22; GMX 466; GFX 1354)

793. I am not finding that the above figures constitute respondents' economic rates of return, but simply that there is a lack of proof of any higher figures.

794. Respondents assert that the rates of return are still overstated by reason of alleged omissions or errors in Dr. Stauffer's calculations.[82] The alleged errors are either not established or are offset by other aspects of the formula, and are minimal in nature particularly in comparision to the three major adjustments I have just ruled upon. The figures stated above, therefore, are sufficiently **[221]**accurate upon which to proceed in the appraisal of respondents' profits.

795. Quaker's accounting rate of return for the period 1958–1970 was 9% (CX 701A).[83] The purpose of Dr. Stauffer's formula is to adjust for those items which improperly are expensed, such as advertising and research and development, and to otherwise adjust for the time sequence of returns on investment in order to reduce the overstated accounting rates of return. As a company which was expanding with new products, Quaker obviously had large research and development and advertising costs which necessitated a downward adjustment. Indeed, Quaker's advertising to sales ratios were consistently higher than Kellogg's and were usually higher than General Mills' and General Foods' (CX 513). Nevertheless, applying Dr. Stauffer's formula with a rectangular cash flow profile and a 10% advertising decay rate, Quaker's 1958–1970 9% accounting rate of return did not go down but increased to a 12.4% economic rate of return. Normally, the higher the advertising decay rate, the higher the resultant economic return. In the case of Quaker, however, just the opposite result occurred. Using a 35% decay rate, its economic rate of return went down to 10%, and with an 80% decay rate, its economic rate of return went still lower to 8% (CX 701Z–22).

[82] All three respondents contend that Dr. Stauffer erred with respect to the timing of tax benefits connected with the expensing of advertising and research and development (KPF 5–102; GMPF 3–102; GF 5–334 thru 5–539). General Mills and General Foods assert that additional downward adjustments should have been made by reason of the quasi-capital nature of such items as promotion, market research and certain selling expenses, as well as product quality control, preventive maintenance and personnel training (GMPF 3–97 thru 3–101; GFPF 5–324 thru 5–533). General Foods asserts that Dr. Stauffer has underestimated the service life of its investments (GFPF 3–104, 3–105) and has incorrectly adjusted perceived differences between tax depreciation lifetimes and book depreciation lifetimes (GFPF 3–106, 3–107).

[83] Kellogg agrees (KPF 5–74) that Quaker has submitted all accounting data needed to calculate rates of return.

796. As discussed above, utilization of a triangular cash flow profile consistently results in a higher accounting rate of return than when a rectangular profile is used. In the case of Quaker, however, just the opposite occurred. Using a triangular cash flow profile, Quaker's economic rate of return was 10.2% at the 10% decay rate, .89% at the 35% decay rate and minus 34.4% at the 80% decay rate (CX 701Z–22).

797. It has been suggested that the unusual results with respect to Quaker flow from the fact that its rate of growth exceeded its rate of return (CPF 11–123; CRPF 11–249; Tr. 31,259, 38,089–90). Whatever the reason, it is clear that Dr. Stauffer's formula is inappropriate to measure Quaker's economic rate of return (Tr. 31,259, 38,089–92), and there is no record evidence of that rate. It may be assumed, however, that it was well below its 9% accounting rate of return.

798. Dr. Stauffer, on the basis of accounting data submitted by Ralston, made certain allocations and assumptions (Tr. 19,156–66, 19,670–76) and, using a rectangular cash flow profile and an advertising decay rate of 10%, arrived at an economic rate of return of 9.9% for 1958–1970 and 10.7% for 1954–1972 (CX 701Z–22).

799. The data submitted by Ralston differed from those supplied by the respondents and Quaker and were somewhat less comprehensive **[222]**(Tr. 19,157). It was necessary, in order to approximate RTE cereal figures, to assume that the relationships between various accounting data for the RTE cereal segment were comparable to such data for the total Ralston corporation (Tr. 19,664, 25,175–80). In 1970, about 1⅓% of Ralston's total net sales were of RTE cereals (Complaint Counsel's Trial Brief, Vol. 1, ¶ 111.21). In light of the small portion of overall corporate endeavor accounted for by RTE cereals, the assumption could well be in error. The significance of any such error is conjectural. In any event, Ralston's rate of return is not substantially higher than the benchmark or normal rate of return contended for by complaint counsel.[84]

No calculations were made for Nabisco as no asset data were secured from that company.

4. *The Benchmark Comparison*

800. Having determined the extent to which rates of return have been established for respondents and others in the industry, it becomes necessary to evaluate those rates to see if they are above

[84] This subject is considered next.

normal, or excessive. There are two definitions of a "normal" rate of return. They are consistent with each other. (1) Economists often define a normal rate of return as that rate which is necessary to attract appropriate capital into an industry (Tr. 21,706, 31,274–75, 31,356, 38,164). (2) A normal rate of return is also defined as one that is necessary to cover all costs of production and distribution including a "normal" or competitive return to capital invested (Tr. 21,692, 21,707, 27,991–92).

801. Rates of return significantly above a reasonable, competitive benchmark rate of return may indicate poor economic performance (Tr. 21,698–700, 21,719–22, 26,119–20). Complaint counsel rely upon the average rate of return earned by firms in the manufacturing sector of the United States economy as an estimate of the normal or competitive rate of return. The data relied upon to calculate this average rate of return for all manufacturing was compiled by the United States Internal Revenue Service ("IRS") in the "Statistics of Income"—the IRS annual summary volume covering income tax filings by all United States firms classified by the IRS in the manufacturing sector of the United States economy (Tr. 19,074–75).[85]

[223]

802. The average accounting rate of return on capital employed for all firms in the manufacturing sector was 8.9% (CX 701A). Using his formula, Dr. Stauffer converted the accounting rate of return to an economic rate (Tr. 19,683 *et seq.,* 19,720–21). There was no great problem of whether to use a rectangular cash flow profile or a triangular cash flow profile, or as to the appropriate advertising decay rate. This is because the benchmark figures overall do not include relatively large expenditures for research and development and advertising, the two principal bases for correction from an accounting to an economic rate of return (Tr. 25,099, 25,438–39). Therefore, there was not a very large correction to be made.[86]

803. Thus, for the period 1958–1970, the benchmark economic rate of return was 8.3% using a rectangular cash flow profile, irrespective of the decay rate. For the same period, the rate was 8.4% using a triangular cash flow profile, irrespective of the decay rate. For the period 1954–1972, using the rectangular cash flow profile, the rate of return was 8.2% with an 80% or 35% decay rate, and 8.1% with a 10% decay rate. And for this longer period, using a triangular cash flow profile, the rate of return was 8.4% with an 80% or 35% decay rate, and 8.3% with a 10% decay rate (CX 701Z–

[85] The IRS data set is the largest and most comprehensive source of such data available and has been used frequently by industrial organization economists studying industry performance (Tr. 19,079–80).

[86] Accounting data had already been corrected with respect to accelerated depreciation (Tr. 25,438).

21, Z–22). Inasmuch as I have used a rectangular profile and a 10% decay rate in reaching respondents' and Ralston's economic rates of return, I shall use the same assumptions for the benchmark. This gives us the following comparisons:

	Kellogg	General Mills	General Foods	Ralston	Benchmark
1958–1970	11.7	10.5	7.3	9.9	8.3
1954–1972	13.2	10.1	6.7	10.7	8.1

804. The respondents and Ralston are large, established firms which have shown profits over a number of years. The benchmark, on the other hand, reflects the activities of 200,000 manufacturing corporations, 40% of which have either no net income or negative income (Tr. 31,275, 31,334, 38,167–68). Based on 1970 figures, when firms which earned no income are excluded from the benchmark, the benchmark rate of return is increased by two points (Tr. 24,922–26, 31,345; GMX 78). Respondents' profits should not be evaluated on the basis of firms which had no income or negative income (Tr. 38,489–90). Therefore, a modification of the benchmark upward by two points is appropriate. This gives us the following: [224]

	Kellogg	General Mills	General Foods	Ralston	Benchmark
1958–1970	11.7	10.5	7.3	9.9	10.3
1954–1972	13.2	10.1	6.7	10.7	10.1

805. There are other biases in the benchmark which cannot be measured. For example, the sample is constantly changing. Many firms go bankrupt each year, while many are just starting up (Tr. 31,278, 38,165–66, 38,489–90). In 1954, there were 120,896 firms in the sample. In 1970, there were 197,807 (Tr. 38,165). New firms frequently have initial periods of very low rates of return or even losses until they get established. This biases the sample downward when it is being used in comparison with established companies whose start-up cost were incurred in the distant past (Tr. 38,166, 38,488–90). In Finding 804, I have adjusted the benchmark to exclude firms with no income. This still leaves firms with low rates of return attributable to their just starting up.

806. The large number of small firms in the IRS sample biases the benchmark average downward because the owners of such firms have a tax incentive to take the firms' profits in the form of high salaries. This results in an understatement of their profitability

relative to large, publicly-held corporations (Tr. 31,278–79, 38,166–67, 38,489–90). Some 80% of the IRS sample is composed of firms with total assets of under a half million dollars (Tr. 38,166–67).

807. When firms acquire others, they normally write up the assets acquired to reflect values at the time of acquisition (Tr. 18,314–15, 22,302, 24,914). Since the assets of the respondents have not been restated to reflect current values, the benchmark is understated to some extent in comparison with respondents.

808. On the other hand, the IRS data biases the benchmark upward to the extent it includes the return to those firms that are earning monopoly profits (Tr. 21,796, 21,798–99, 26,104, 27,990).[87]

There are two additional factors that must be considered before meaningful comparisons may be made between RTE cereal companies' rates of return and the benchmark. These are (1) inflation and (2) risk.

(a) Inflation

809. Dr. Stauffer made no adjustments for inflation, since he was not trying to compute absolute levels of profitability, but **[225]**rather to compare relative levels (Tr. 19,890–92). Thus, for both the RTE cereal companies and the benchmark, the fixed asset portions of capital investments were valued at cost at the times of purchase and were not adjusted upward to reflect current, inflated values (Tr. 18,314–15, 22,302, 35,887). Inflation, however, has a material effect on profit measurement. The issue is whether inflation has affected the individual RTE cereal firm computations and the IRS benchmark to the same degree (Tr. 19,891–92, 21,702, 21,707, 31,214, 31,231–34, 31,244, 31,254, 35,887–900, 38,482–84, 38,522–24).

810. The impact of inflation varies from firm to firm (Tr. 35,888–91, 35,896–900). Firms that have particularly old stocks of fixed assets will have their accounting statements affected by inflation to a relatively greater degree (Tr. 21,707). The bias on profits due to inflation is aggravated when computing the accounting rate of return by the expensing of quasi-capital expenditures, such as exploration, research and development and advertising (Tr. 25,126–27; KX 17, p. 13). The RTE cereal firms would appear to have older fixed assets than the average firm (CPF 12–62; Tr. 29,439). They engage in a considerable amount of research and development and clearly advertise much more than the average firm. Consequently, it must be concluded that the failure to account for inflation has

[87] However, Dr. Schmalensee, one of complaint counsel's economists, has testified that any such bias would be small (Tr. 21,799).

caused a greater upward bias on the computation of profits of the RTE cereal firms than on the benchmark.

(b) Risk

811. A higher than average return is still considered competitive or normal if the amount above the average is compensation for above-average risk. A normal rate of return for a business with above-average risk would be greater than for less risky businesses. And if an industry is risky, a potential entrant would require a higher than average return before it would consider entering (Tr. 21,706, 21,720–22, 23,233, 26,582–85, 38,486–87, 38,491–92, 38,517).

812. RTE cereal companies must introduce new products in order to remain profitable and compete for market share, and competition by introduction of new products has been intense (*supra,* Findings 530–31, 533).

813. As I have already found (Findings 652–53), after evaluating the high capital costs of entry, the long lead times required to recover capital investments, the costly and time consuming and often insurmountable problems of developing an acceptable product (with Procter and Gamble's experience cited as an example), the high failure rate of new products, and General Food's and Nabisco's drastic decline in market shares: **[226]**

> . . . A potential entrant would not normally anticipate emulating the apparent success of the leading company, Kellogg, but would be forewarned of risks by the experience of other competitors. And General Foods' growth rate and experience would indicate a degree of risk and lack of attractiveness for new entry.
>
> This observation of high risk would deter a potential entrant from entering the RTE cereal industry, unless it could foresee a rate of return higher than normal in order to compensate for the risk it would be incurring (citations omitted).

I then went on (Finding 664) to note the inability of Pillsbury, Colgate, International Multifoods, Carnation and H.J. Heinz to remain in the industry, a further indication of the risky nature of the industry.

814. Risk is further reflected by General Foods' drop in rates of return from 7.7% for the 1954–1970 period to a minus .1% for the period 1966–1970 (Tr. 38,125–26);[88] also by Nabisco's low, but highly variable, sales return on capital.[89]

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[88] The rate of return was calculated with a rectangular profile and a decay rate of 10%, but used Dr. Mellman's allocations rather than those contended for by respondents.

[89]

Year	Percent
1962	1.9
1966	0.8

(Continued)

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815. The benchmark derived from IRS data for the manufacturing sector cannot be deemed to draw an absolute line of demarcation between normal and monopoly profits. While such IRS data have generally been relied upon by economists, there is concededly some degree of inexactitude (Tr. 19,930, 25,534, 25,640, 25,646, 26,233; and note the various biases enumerated above). Further, the benchmark is simply an average of firms' earnings below the average and firms' earnings above the average. It cannot be said that every firm earning above average, whose rate of return contributed to reaching the average, is earning monopoly profits. Finally, while **[227]**not quantified, considerations of inflation and risk establish a normal rate of return for the RTE cereal respondents at a somewhat higher level than an average benchmark.

816. In consideration of the above, while the benchmark may be used as a rough guideline to aid in evaluating rates of return, a rate of return cannot be said to be monopolistic or supracompetitive unless it is substantially in excess of the benchmark. That is not the case here. General Foods' rate of return is substantially below the benchmark. Quaker's return may be assumed to be below it (Finding 796). General Mills' and Ralston's rates of return approximate it. Only Kellogg is shown to have a rate of return in excess of the benchmark; and, in consideration of the variables and biases discussed above, its rate cannot be said to be substantially in excess.

817. Even if Kellogg's rate of return were deemed to be substantially in excess of the benchmark, this would not evidence a violation under the complaint. The complaint alleges a shared monopoly and Kellogg would not be shown to have shared its allegedly monopolistic return with any other RTE cereal manufacturer. Kellogg was not charged with enjoying an individual monopoly nor could it with, at most, 44% of the market (*supra,* Finding 168).

818. Since the benchmark average is reached by combining a variety of rates of return which range above and below it, it is not suggestive of improper industry structure to find a distribution in the RTE cereal industry of one company (Kellogg) having a rate of return above the benchmark, two (General Mills and Ralston) with

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1967	.6
1968	4.9
1969	1.1
1970	1.4

rates of return approximating the benchmark, and two (General Foods and Quaker) with rates below the benchmark.

Again, I want to make it clear that I have made no findings of what respondents' and Ralston's economic rates of return have been. I have simply found those rates above which there is a lack of proof, and I have compared those rates with the benchmark.

5. *General Foods' Profitability*

819. The record establishes that General Foods did not earn above-normal (supracompetitive) profits.

820. Complaint counsel (CPF 11–122), while contending that General Foods earned profits in excess of the competitive rate of return, recite that General Foods suffered poor management, committed costly errors in brand introductions and possessed an inferior production plant. More specifically, complaint counsel assert that General Foods had problems with its management and advertising agency due to a lack of continuity in personnel; that it had extraordinary failures in product development, losing over $12 million alone on just three projects from 1966 to 1970; that General Foods recognized that its failures in new product development had "a [228]major negative effect on total cereal business profitability;" that it operated its plant at only 60% of capacity and had the least flexible, most dated and expensive to operate production facility of the major manufacturers.

821. Other matters, not recited by complaint counsel, include the following. General Foods, since at least 1952, considered that its RTE cereal profit margin was so low that it did not merit reinvestment in the business and did not provide sufficient contribution to overall corporate results (Tr. 36,369).

822. From 1952 to 1966, while the overall RTE cereal market grew 4% per year and the adjusted gross national product grew 3.6% per year, General Foods' RTE cereal annual growth was only 1.1% (GFX 1321). General Foods' market share over the period 1962 to 1970 declined from 19.7% to 14.0% (CX 106A, C). Its new product activities were overall costly failures (CX–GF 4039Z–17).

823. In light of its poor performance, General Foods organized a task force in November 1966 to study its RTE cereal business. One of the assignments of the task force was to decide whether General Foods should remain in the RTE cereal business (Tr. 23,617–19, 36,404; CX–GF 4039D–E). The task force recommended that General Foods remain in the business, in large part, because of large fixed costs already associated with its plant (CX–GF 4039E).

824. A second task force was organized in 1971 because management again was greatly concerned whether General Foods had the ability to compete (Tr. 13,884–85).

825. The 1967 task force reported that new cereals as a group had yet to show a profit, and the 1971 task force reported a $13.1 million loss on new products since 1967 (Tr. 38,137–38; CX–GF 3000Z–167, 4039Z–5). In light of the importance of new products to effective competition in the RTE cereal market, this in itself reflects unsatisfactory profits.

826. It is hard to believe that General Foods, after some 70 years in the RTE cereal industry, would have considered getting out and absorbing the losses this would have entailed if it were earning a normal profit. A decision to close a business permits an inference that below-normal profits are being earned (Tr. 26,512–13). General Foods' consideration of quitting the RTE cereal industry allows a similar inference.

827. Complaint counsel (CPF 11–122; CRPF 11–238) would attribute General Foods' relatively low rates of return to poor management, costly major errors in brand introductions and inferior production plant. Without passing judgment on General Foods' management's expertise or on the wisdom or lack of wisdom in going forward with the new products that it developed (which I certainly am not qualified to do on the basis of this record), this would appear to reflect the risk facing a competitor in the RTE cereal industry. Further, to the extent General Foods' relatively low rate of return **[229]**can be explained away by poor management decisions and unsuccessful products, Kellogg's and General Mills' relatively higher rates of return may reflect superior management and superior products.

6. *The COMPUSTAT Comparisons*

828. COMPUSTAT is an organization which provides financial data on some 1,000 corporations. The COMPUSTAT data tape is a computer tape which records the financial information of such corporations. The data is taken from several sources, primarily the firms' 10–K filings with the Securities and Exchange Commission (Tr. 19,163, 19,750–52, 19,755).

829. Dr. Stauffer computed an average economic rate of return for some 400 firms on the COMPUSTAT tape for which he had sufficient information, and arrived at a rate about .5% higher than the IRS benchmark (Tr. 19,758). The firms listed on COMPUSTAT are relatively large and successful (Tr. 24,771). They account for

approximately 75% of all the assets in the IRS Statistics of Income (Tr. 19,755).

830. Dr. Stauffer had considered using COMPUSTAT data to arrive at his benchmark. He did not, but utilized the IRS data as his only benchmark as he needed figures reflecting a larger and more representative sample of corporations (Tr. 24,755–58). The benchmark derived from IRS data, as modified above, is more reliable. In any event, the inflation and risk factors would still justify a higher rate of return for the RTE cereal industry than for the average COMPUSTAT rate.

831. Dr. Stauffer also did a dispersion analysis whereby he ranked firms covered by COMPUSTAT according to their profitability. Dr. Stauffer calculated economic rates of return for each of the firms in the COMPUSTAT data base for which there was sufficient data and then ranked the firms according to their rates of return. These included, for particular years, between 500 and 1,000 firms which are listed on the New York and American stock exchanges (Tr. 19,750–51, 19,755, 21,800; CX 701Z–23 thru Z–26). Dr. Stauffer prepared a graph covering the period 1958–1970 showing the percentage of COMPUSTAT reported companies that earned various economic rates of return (CX 701Z–23, Z–24, Z–25). Each cited exhibit shows the same graph for the COMPUSTAT companies. On each graph was plotted rates of return of the three respondents, Quaker and Ralston and a composite of those five cereal companies, under different cash flow profile and decay rate assumptions. The only exhibit to which further reference will be made is CX 701Z–25, as that purports to plot the economic returns of Kellogg, General Mills, Quaker, Ralston, and the composite of five cereal companies (the four mentioned plus General Foods) under a rectangular cash flow profile and a 10% decay rate.

832. Of all the companies plotted, only the entries for Kellogg and Ralston reflect what I have found to be the extent to which their rates of return have been established. Kellogg, with a rate of **[230]** return of 11.7%, falls among the top 16% of the most profitable firms in the manufacturing sector of the United States. Ralston, with a 9.9% rate of return, falls around the 30% mark. While Quaker is listed on the exhibit as being among the 12% most profitable companies with a 12.4% rate of return, I have already found that complaint counsel have failed to establish an economic rate of return for Quaker, but that Quaker's economic rate of return may be assumed to be well below 9% (Finding 797). Further, CX 701Z–25 uses the cash flow profile and decay rate which results in the highest rate calculation for Quaker among the various assumptions. General

Mills is plotted as having a 13% rate of return, whereas complaint counsel have failed to prove a rate any higher than 10.5%. This would place General Mills among the 23% most profitable companies rather than among the top 10% as depicted by complaint counsel. General Foods, whether at the 7.7% rate computed by complaint counsel or at the 7.3% limit I have found, has a rate of return so low that it is not depicted on the chart. The chart indicates that the 40% most profitable corporartions have a rate of return of 9% or more. The composite of five cereal companies which shows a weighted return of 11.6%, which would place that figure within the returns earned by the 16% most profitable corporations, is in error since it is composed in part of overstated returns for General Mills and General Foods and a clearly overstated return for Quaker for which no return has been established.

833. Further, the significance of the dispersion of rates of return and the ranking of firms in profitability categories is weighted by the fact that a firm earning a rate of return equal to the IRS benchmark of a normal rate of return (10.3%) would be among the 26% most profitable corporations in the manufacturing sector. This is because the firms listed by COMPUSTAT are large and successful and account for 75% of all of the assets in the IRS Statistics of Income.

834. As stated in the prior section, "Impediments To New Entry In The RTE Cereal Industry," complaint counsel's theory of the existence of a barrier to entry into the RTE cereal industry is premised in part on the assertion that the industry has enjoyed supracompetitive profits. As I have found in this section, this premise fails for lack of proof.

C. *Innovation As A Measure of Performance*

Complaint counsel assert (CPF 11–128, *et seq.*) that respondents have not been innovative in their efforts to bring new and better products to consumers; that their new product developments have been essentially variations of existing RTE cereal products rather than innovations; and that respondents resisted widespread vitamin fortification even though they believed it would provide consumers with new and better products. **[231]**

835. This last stated aspect of complaint counsel's assertion has already been found to be without substance. Respondents were innovative both in restoring their RTE cereals to whole-grain levels and in fortifying their products with vitamins and minerals (Findings 491–524).

836. Complaint counsel (CPF 11–129 thru 11–171) rely upon

evidence that tends to show the similarity of many RTE cereal products that were introduced to products already on the market. From this they argue that respondents have performed poorly in that they failed to be innovative in their introduction of products. Respondents, on the other hand (KPF 5–158, 5–159, 5–161 thru 5–163; GMPF 2-166 thru 2-169, 2-171, 2-175; GFPF 7-68 thru 7–139), rely on evidence which points up the differences between products and purports to establish the significance of those differences.[90]

837. Upon a review of the evidence, including many product formulas, it does appear that a number of RTE cereal products are quite similar without "earth shaking" differences. However, it also appears that complaint counsel are raising a question of the consumer welfare significance of new product introductions; and this is not a question for my judgment in this case. Any product that expands the choices of a consumer is an innovation. The signififance of an innovation is determined by its success in the marketplace (Tr. 23,264–65, 23,391, 26,689–90). Whenever Kellogg introduced a product similar to that of a competitor, Kellogg believed that its product was superior (Tr. 29,805). During the complaint period, Kellogg nationally introduced 16 RTE cereal products, all but three of which were still on the market at the end of the period (Tr. 29,600–01; CX–K 1067, 7173; CX 434). By 1971, some 37% of all RTE cereal sales were of products introduced during the prior sixteen years (GMX 564).

838. I have already made findings relative to respondents' competition by the introduction of new products (Findings 530–602). Pertinent to the present issue are the findings that respondents have engaged in intense, unrestrained and uncoordinated competition in the introduction of new products; that each respondent attempted to seize every new product opportunity before its competitiors, but, at the same time, tried to introduce similar products to compete with particular products of competitiors; that each company was fully organized to recognize, evaluate and develop all perceived product opportunities.

839. The extent to which complaint counsel have been able to point out relatively insignificant product differences does not **[232]** evidence a failure to be significantly innovative. To the contrary, it demonstrates the extent to which respondents try to take advantage of every product opportunity. If respondents find it competitively expedient to beat their rivals to relatively insignificant product holes, it is all the more important that they vie for more significant

[90] Much of this evidence is in the nature of testimony of witnesses whose testimony I am required to accept at face value.

innovations. There is no evidence that they have not done so. And so we find that all respondents have competed by restoring and fortifying cereals with vitamins and minerals (*supra,* Findings 492–528); and that General Foods experimented with the inclusion of phosphates to inhibit dental caries (*supra,* Finding 511) and experienced costly failures in its efforts to develop and introduce cereals with freeze-dried fruits (*supra,* Finding 594).

840. There is no reason to believe that respondents have not attempted to come up with all reasonable innovations consistent with anticipated consumer acceptance.[91] Neither complaint counsel nor I are in a position to pass judgment on what, if any, additional significant innovations the industry could or should have come up with. It cannot be found that something more dramatic should have been developed, or that there are areas where innovativeness was neglected. The only area specifically alleged by complaint counsel to have been neglected is that of product fortification, and that allegation has been found to be unsubstantiated.

841. In addition to new product introductions, respondents have innovated production changes. Kellogg, for example, has improved its knowledge of how to work with grains over time and has continually made changes in product formulation, production and packaging which it considers to be improvements (Tr. 29,318, 29,790–91, 29,896, 29,974). It has been able to increase the running time capabilities of some of its product lines (Tr. 29,897–98). Certain products are made by different methods which are improvements over how they were made some years ago (Tr. 29,270–72, 29,278, 29,298–302).

842. General Mills spent over seven years in researching and developing the continuous puffing gun which replaced the batch gun. This increased product uniformity and eliminated problems that occurred with the start-up of each operating period. Each continuous puffing gun replaced six batch guns. Labor efficiency was increased fourfold. The shift-over resulted in less maintenance, a reduction of start-up times and a need for less floor space (Tr. 33,016–23, 33,127–30).

843. From 1961 to 1973, General Foods made 115 product changes on 17 of its trademarked brands. Eighteen were process improvements, 26 were formula changes designed to affect the nutritional value of **[233]**the products and 71 were other formula changes. Thirty-five of the 115 product changes were intended to lower costs without noticeably changing customers' acceptance of

[91] Procter and Gamble, after six years and up to $1 million in expenditures, was unable to develop a product that it felt would receive consumer acceptance (*supra,* Finding 651).

products. In General Foods' current view, the purpose of the other 80 product changes was to improve the quality of the product (GFX 1370I).

D. *Wastefulness In Advertising Expenditures*

844. Since monopoly power is the ability to hold prices above competitive costs (Tr. 21,707, 26,100–05), the operation of businesses with excessive costs may manifest monopoly power and poor performance. Efficient firms will minimize their costs (Tr. 21,693, 27,655). Complaint counsel assert (CPF 11–185) that advertising cost levels in the RTE cereal industry are excessive and are imposed on consumers as a result of the existence of monopoly power. The following table shows advertising expenditures as a percentage of dollar sales for the years 1950 through 1972 for the six largest RTE cereal companies.

SIX FIRM ADVERTISING-TO-SALES RATIOS

	Kellogg	General Mills	General Foods	Quaker	Nabisco	Ralston
1950	.131	NA	NA	.166	.105	NA
1951	NA	.165	NA	NA	NA	NA
1952	NA	NA	NA	NA	NA	NA
1953	NA	NA	NA	NA	NA	NA
1954	.127	.175	.138	.186	.065	NA
1955	NA	.175	NA	NA	NA	NA
1956	NA	.176	NA	NA	NA	NA
1957	.124	.157	NA	.177	NA	NA
1958	.146	.185	.161	.218	.229	.211
1959	.172	.226	.159	.196	.173	.240
1960	.163	.174	.148	.207	.140	.296
1961	.153	.202	.135	.279	.152	.294
1962	.152	.184	.147	.256	.159	.288
1963	.152	.206	.153	.214	.192	.258
1964	.152	.202	.170	.202	.206	.232
1965	.166	.224	.186	.218	.218	.212
1966	.157	.198	.210	.202	.222	.218
1967	.156	.207	.221	.201	.174	.220
1968	.121	.173	.184	.210	.148	.162
1969	.121	.161	.154	.162	.105	.176
1970	.106	.132	.163	.164	.094	.185
1971	.097	.127	.147	.195	.112	NA
1972	.094	.148	.138	.131	.130	NA

NA - Not available.

(CX 513) [234]

845. This shows that the ratio of Kellogg's advertising-to-sales (A/S) ranges from over 9% in 1972 to over 17% in 1959. From 1950 to 1972, the Kellogg ratio exceeded 10% in 16 of the 18 years for which there is data. From 1951 through 1972, General Mills' A/S ratio exceeded 12% in each of the 20 years for which there is data. At its peak, in 1965, General Mills' A/S ratio exceeded 22%. From 1954 through 1973, General Foods' A/S ratio exceeded 13% in each of the 17 years for which there is data. General Foods' highest A/S ratio was reached in 1967 when it exceeded 22%.

846. The most information on advertising and sales for other industries exists for the years 1963 and 1967 (Tr. 27,676–78). The RTE cereal six company total advertising divided by the six company sales figure is .175 for 1963 and .172 for 1967.

847. A/S ratios for many manufacturing industries are reported in Stanley Ornstein's book, *Industrial Concentration and Advertising Intensity,* at pages 60–61 (1977). The mean A/S ratio calculated by Dr. Ornstein for 87 consumer goods industries was 3.8% in both 1963 and 1967, while the RTE cereal A/S ratio exceeded 17% in each of those years (Tr. 27,676–78).

848. The appendix to Dr. Ornstein's book separately reported A/S ratios for more than 320 manufacturing industries. Among the reported industries was Census Industry #2043, Cereal Preparations, which is somewhat more inclusive than the RTE cereal industry, but is the closest category to RTE cereal for the purpose of making an A/S ratio comparison. Cereals had the second highest A/S ratio of all manufacturing industries in both 1963 and 1967 (Tr. 27,677–78).

849. Of the A/S ratios of 42 industries listed by advertising economists William Comanor and Thomas Wilson,[92] only two were double-digit, one of which was of the RTE cereal industry.

850. Kellogg recognized that its advertising made it the most heavily advertised brand name on the American scene (CX–K 565K).

851. Respondents' high A/S ratio does not establish that their advertising has been wasteful. As previously found (Findings 425–443), respondents independently set levels of advertising for each individual product based upon their own judgments of required **[235]** advertising levels to reach or maintain projected sales levels. This record provides no basis upon which to substitute my judgment for that of respondents.

852. My feeling is comparable to that expressed by Dr. Schmalansee in *Brand Proliferation and Entry Deterrence: The Ready-To-Eat*

[92] Comanor, William S., and Wilson, Thomas A., *Advertising and Market Power,* (1974).

Cereals Case, Report, Bell Journal of Economics, February 1977, at p. 41, that it has not been established "that the existing level of advertising in RTE cereals is above the socially optimal level." Further, I do not believe it to be appropriate to mandate a "socially optimal level" of advertising in place of one reached as a result of competitive considerations. Our concept of a free competitive system does not envision imposition by government of permissible levels of advertising.

853. Advertising performs a necessary and legitimate function of advising prospective customers of the attributes of products offered for sale (Tr. 12,809, 22,475, 31,509, 26,665–67; CX–K 456; CX–GF 4039Z–94). Advertising may be used in lieu of alternative methods of promotion and its success may increase sales volumes and so reduce unit costs (Tr. 22,490–91, 28,557, 29,911). Advertising is particularly important in the RTE cereal industry where there are many nonhomogeneous products and competition is carried on in large measure by the introduction of new products.

854. The large number of nonhomogeneous products, each with its requirement for separate advertising, dictates a relatively high A/S ratio. This requirement is further impacted by the high incidence of new product introduction.

855. Introductory advertising is designed to inform people of the existence of the new product and its important attributes. Introductory advertising levels are usually higher than subsequent levels because, in order to best get a return on the product, the length of time spent penetrating the market must be as short as possible (Tr. 12,809, 31,509). Speed is desirable in order to establish a sales base quickly so that both the manufacturer and retailer can determine whether there is a good market for the product and enough people will buy it frequently enough for each to make money (Tr. 15,242). The advertising behind a product is important to the retailer because it shows whether the manufacturer believes in the item strongly enough to support it. Heavy advertising programs are required to help persuade retailers to stock new products (Tr. 9185, 29,911). Also, it may be necessary to increase the advertising on existing products to help combat the introduction of new products by others (*supra,* Findings 126, 545–46).

856. Complaint counsel themselves have contended (CRPF 8–283) that A/S ratio comparisons between respondents are not meaningful without adjustments for the introduction rate of new products. It follows that A/S ratio comparisons between the RTE cereal industry and other industries are also not meaningful without taking into account the heavy incidence of new product introduction in the RTE

[236]cereal industry. Not only is there the incidence of heavy advertising in connection with the sales of successful new RTE cereal products, but the heavy advertising of products that fail also increases the overall company A/S ratio. General Foods, for example, was concerned with wasted advertising expenditures on unsuccessful products (CX–GF 4039Z–22).

857. There are still other differences between industries which do not permit a meaningful comparison of A/S ratios. The nature of the product may differ to the point of justifying different levels of advertising expenditures, or electing between different methods of advertising (with different costs) or choosing between advertising and other forms of promotion (Tr. 22,464–67, 28,143–45). For example, advertising expenditures in the automobile industry exceed the level in RTE cereal, but the dollar volume of sales is so much greater that the advertising-sales ratio is lower (1972 Census of Manufacturers, Special Report, SR 2–6; SR 2–144).

858. Thus, a comparison of A/S ratios between industries, without more, does not allow an evaluation of whether the advertising in an industry is inefficient or is above an economic optimal level (Tr. 31,595).

859. Complaint counsel would substantiate their premise that respondents' high A/S ratios reflects advertising inefficiency and waste by reliance upon the Dorfman-Steiner principle.[93] The Dorfman-Steiner principle is composed of two parts. First, firms try to maximize their profits in choosing, among other things, the level of their advertising expenditures. Second, there are diminishing marginal returns to advertising, *i.e.*, as firms increase their advertising, the additional impact on sales decreases (Tr. 28,004–07). For example, an additional $1,000 expended for advertising might cause the sale of an additional 5,000 units, but the next additional $1,000 expended for advertising might cause the sale of only 2,000 more units. A point would be reached where the marginal return on the additional volume of sales would not equal the cost of the additional advertising that brought about those sales.

860. These two principles lead to the conclusion that the level of advertising is affected by the difference between selling price and marginal costs (the gross margin). The firm's profit-maximizing level of advertising will be higher when gross margins are higher, because the marginal returns to that advertising will be higher. Thus, the higher the price, all else including unit production costs being equal,

[93] Dorfman, Robert and Steiner, Peter, "Optimal Advertising and Optimal Quality," *The American Economic Review*, Dec. 1954.

the larger will be the expenditure on advertising (Tr. 28,004–12; CX 1008). **[237]**

861. The gross margin, or price-cost margin, is simply sales minus manufacturing costs divided by sales. More specifically, it is calculated as the value of shipments less payroll and materials costs divided by the value of shipments, *i.e.:*

$$\text{PCM} = \frac{\text{Value of shipments} - (\text{payroll costs} + \text{materials costs})}{\text{Value of shipments}}$$

(Tr. 27,698, 27,714).

862. Price-cost margins were calculated directly from the industry statistics contained in Table 1B of Volume 2 of the 1972 *Census of Manufacturers* and were verified later with accounting data supplied by Kellogg and General Foods. The *Census of Manufacturers* is published approximately every five years and is publicly available (Tr. 27,703–06).

863. The cereal industry is classified as Standard Industrial Classification Code (SIC) 2043 by the Bureau of Census. The industry classification includes hot cereal and some baby cereal. The Census data shows that the PCM for the cereal industry is 48%. This was the ninth highest price cost margin of 451 manufacturing industries (Tr. 27,719–20). The same tables of the 1967 *Census of Manufacturers* show that the cereal industry was tied for the sixth highest price-cost margin of the 412 industries reported (Tr. 27,720).

864. PCMs are not reliable measures of profitability, such as are the economic returns on capital employed, the measures actually relied upon by complaint counsel in this case.[94] PCMs, for example, do not take into account distribution and selling costs, capital intensity, research and development, risk and various timing factors. In the absence of proof that any firms in the RTE cereal industry were enjoying supracompetitive economic returns, and the established fact that General Foods and Quaker were not, it cannot be held that any RTE cereal advertising was caused by monopoly profits. **[238]**

865. The Dorfman-Steiner principle is just that—a principle or theory of how gross margins will be expended on additional advertising. It does not take into account the extent to which

[94] Complaint counsel, in a section dealing with price competition (CPF 8–14) assert that the RTE cereal industry is extremely profitable as shown by its price-cost margins. This is an isolated reference and the contention is not developed or even referred to in the sections of their brief dealing with the issue of excess profits (CPF 11–18 thru 11–127). PCMs constitute an incomplete view of corporate activity and are not reliable indicators of the state of competition in an industry (Tr. 26,100, 31,581).

advertising expenditures will be dictated by competitive requirements.[95] And, as previously found, competitive requirements in the RTE cereal industry necessitate high advertising expenditures. The Dorfman-Steiner principle would not apply to the advertising of products which turn out to be failures; and it may well be that the costs of introductory advertising together with those of introductory promotions could exceed the gross return on new products for some time, so that there is no price-cost margin to consider expending for additional advertising.

866. Thus, the Dorfman-Steiner principle cannot be applied with the surety that advertising levels are coordinated with PCMs. This is apparent from an examination of the A/S ratios and gross margins of firms in the RTE cereal industry. Here, we find that General Mills has a higher gross margin than Quaker. Yet, Quaker's A/S ratios are consistently equal to or higher than those of General Mills. Kellogg's and General Foods' gross margins are close, but General Foods has much higher A/S ratios:

COMPARISON OF GROSS MARGINS (GM) AND ADVERTISING-SALES (A/S) RATIOS 1966–70

	Kellogg		General Mills		General Foods		Quaker	
	GM	A/S	GM	A/S	GM	A/S	GM	A/S
1966	.36	.16	.44	.20	.36	.21	.39	.20
1967	.36	.16	.44	.20	.37	.22	.42	.20
1968	.36	.12	.45	.17	.39	.18	.40	.21
1969	.36	.12	.47	.16	.39	.15	.40	.16
1970	.36	.11	.49	.13	.39	.16	.41	.16
1966–70	.36	.13	.46	.17	.38	.19	.40	.19

(Source: GMX 239, 553A).

867. Complaint counsel (CPF 11–200) assert that the pricing and advertising of Kellogg's Corn Flakes in the late 1960's and early 1970's evidences that the Dorfman-Steiner principle has operated in **[239]**the RTE cereal industry. Sales of Kellogg's Corn Flakes were going down coincident with Ralston's private label price competition. Kellogg maintained its list prices through 1970. It reduced advertising expenditures between 1966 and 1972, as well as its A/S ratio, but granted case allowances in 1968, 1969, and 1970 and reduced list

[95] For example, firms increase the advertising on particular products in anticipation of the introduction of competitive products (Tr. 22,133–34).

prices in 1971 (Tr. 17,528, 28,014–16; CX–K 856, 868, 1072, 7073B, 7083B, 7192G–H; GFX 1318, 1319).

868. It cannot be said to what extent the pre-1966 advertising levels reflected advertising requirements or, if at all, an application of the Dorfman-Steiner principle. The same may be said of Kellogg's actions taken after 1965.

869. The Corn Flakes situation is an isolated instance which may reflect a myriad of business considerations and cannot be relied upon to characterize respondents' advertising practices overall. Their practices overall are more properly evidenced by the comparison of gross margins and A/S ratios which has been considered above. In any event, advertising is engaged in to produce sales and profits, and there is nothing amiss for a manufacturer to increase advertising to the point of realizing all marginal returns possible. In the absence of a showing that respondents were earning supracompetitive profits, their advertising levels, even to the extent thay may be based on marginal returns, cannot be termed inefficient or wasteful.

870. In summary, I start with the basic assumption that advertising is a viable and legitimate method of competition. And complaint counsel have failed to demonstrate that the large volume of advertising in the RTE cereal industry does not have a competitive basis or that it reflects the existence of supracompetitive profits. A firm advertises in order to generate or increase sales and so increase profits. At the same time, once profits are realized, or in anticipation of profits, the firm may increase advertising up to the point of realizing all possible marginal returns. This, however, is pure theory and no findings can be made as to the extent respondents have increased normally competitive advertising levels to take advantage of the Dorfman-Steiner principle.

871. While the Dorfman-Steiner principle is logically sound, there is still another basic principle; and that is that, at a lower price, there may be a greater potential to sell more products, so that a firm with lower prices may increase its advertising to reach its potential (Tr. 31,590, 31,595).

Complaint counsel (CPF 11–205 thru 11–208) assert that respondents have engaged in wasteful advertising by misdirecting consumers to products which do not have the attributes or advantages over other products claimed in their advertising. Complaint counsel have abandoned their claims that respondents' advertising was false and misleading (Tr. 29,073; Complaint Counsel's Answer To Respondents' Motions To Dismiss, February 24, 1978, at A–14, A–15), and the issue cannot be resurrected at this time. **[240]**

E. *Waste and Misallocation of Resources*

In the introductory portion to their section on performance (CPF 11–12), complaint counsel explain an aspect of consumer loss when an industry prices above cost. "This is due to the law of demand—the higher the price, the lower the quantity demanded of a good. Whenever an industry prices above the competitive level, consumers demand less than they normally would, output is restricted, and thus, resources which should have been devoted to production of the good will be diverted to other goods and a misallocation of resources results . . ." (Tr. citations omitted). Complaint counsel then quote from economist, Clair Wilcox (C. Wilcox, Public Policies Toward Business, 11 (1955)), in part, as follows:

> The mobility characteristic of competition thus tends to achieve the allocation of resources that consumers desire. Monopoly, by contrast, frustrates such an allocation. The monopolist is likely to increase his profit by raising his price. *He will then limit his output to the quantity that the market will take at the price that he has fixed.* Consumers who would be willing to purchase larger quantitites of his product at a lower price are left, instead, to buy goods that are wanted less. Resources are thus diverted from those things which the community prefer to those which are, at best, a second choice (emphasis supplied).

Complaint counsel then conclude (CPF 11–13):

> The loss that results when resources are misallocated is called the "deadweight" or "welfare" loss . . . (Scherer, Tr. 27,999–28,000). "It is a loss of value that the consumers would have realized if they could have consumed at prices equal to cost. So consumers lose it. *It is an inefficiency that comes from the restriction of output by monopolists* causing consumers willing to pay a price greater than the cost not to be able to make those purchases" (Scherer, Tr. 28,000) (emphasis supplied).

872. While this aspect of the economic law of supply and demand is stated in general terms, complaint counsel obviously intend it to be descriptive of the RTE cereal industry. Complaint counsel, however, have failed to show how the law of supply and demand has **[241]**impacted the cereal industry or its customers. The record does not support complaint counsel's assumption that there have been high prices in the RTE cereal industry to the extent that demand has been impacted and producers have curtailed supply.

873. The cereal industry has experienced rapid and substantial growth, indeed substantially faster than the growth of all goods and services and faster than the growth in real output of the economy as a whole (*supra,* Findings 162–66). RTE cereal prices have been maintained at a level substantially lower than those of most other breakfast foods (*supra,* Findings 49–50), and price differentials in favor of hot cereals have not impacted the sales of RTE cereals

(*supra,* Finding 50). The RTE cereal industry is less price sensitive than other commodity industries (Tr. 23,113, 27,134), and the cost of RTE cereals is not a very important component of the total food budget (Tr. 27,142).

874. Consumers are being offered a large number of RTE cereal products at various prices from which to choose. At the lower edge of the pricing spectrum, we find the leading RTE cereal product, corn flakes. Consumers who may be interested in the lowest available prices may choose from Kellogg's Corn Flakes, General Foods' Post Toasties, General Mills' Country Corn Flakes and private label corn flakes (*supra,* Finding 72; Tr. 16,611, 17,750, 25,815–16, 28,821). The presence of private labels in this segment would mean the availability of prices even lower than those of the branded products.

875. There is no showing that any consumers are being priced out of the market. And, as Dr. Scherer testified, if buyers are able to purchase a product at a price they are willing to pay, even though the price exceeds the manufacturer's costs, allocative efficiency is being staisfied (Tr. 27,652).

876. On the other side of the coin, there is no evidence that respondents have limited supply. Each company has attempted to come up with new products to replace volume attrition of existing brands and to increase its market share (*supra,* Findings 533–40). While General Foods was relatively unsuccessful in its efforts, both Kellogg and General Mills have maintained their operations at a high level of capacity (*supra,* Finding 407; Tr. 26,726).

877. Economist Michael Glassman, introduced by complaint counsel, has suggested that Kellogg, for example, could sell more if it were to lower its prices (Tr. 26,569), and that it could meet that increased demand by building more capacity (Tr. 26,726). This suggestion is rejected. Kellogg has the right to exercise its own judgment with respect to operating under current production capacity. Kellogg, which enjoys some 40% of the market, may well believe that it is already supplying all of its cereals that the consuming public wants, and that it would not be economically feasible to make additional capital investments. **[242]**

878. In summary, there is no showing that consumers have reduced their overall consumption of RTE cereals because of alleged supracompetitive prices; nor is there any showing or reason to believe that, if prices were lowered, demand or supply would be increased.[96]

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[96] I am not finding that the RTE cereal industry is immune to the impact of the economic law of supply and demand; simply that there has been no showing that extant prices are so high as to have reduced demand or supply.

F. *Consumer Overcharge Calculation*

Complaint counsel (CPF 11–209 thru 11–232) utilize several alternative methods to calculate the amounts by which consumers have been overcharged by reason of respondents' alleged supracompetitive profits. Having found a lack of proof of supracompetitive profits, there are no overcharges to calculate. Nevertheless, some of complaint counsel's methods of computing the asserted overcharges merit comment. Complaint counsel recite (CPF 11–212):

> In July 1971, Kellogg reduced the list price of its Corn Flakes by 16%, from $6.90 for a case of 24 12-ounce boxes to $5.80 for a case of 24 12-ounce boxes (CX–K 7192G, 7083B, 7073B; Scherer, Tr. 28,015). In order to "still show an impressive price spread" between Ralston's private label Corn Flakes and Kellogg's Corn Flakes, Ralston reduced its prices from $5.80 a case to $5.50 (CX–R 1516A).

From this, complaint counsel argue (CPF 11–213) that the price of Kellogg's Corn Flakes had been inflated by at least 16% due to monopoly power; and that it is likely that all RTE cereal prices have been inflated by a comparable amount. Complaint counsel (CPF 11–214) then take 16% of the total sales of branded products and arrive at a $1,037,980,000 overcharge for the three respondents for the years 1958–1972 and a $1,223,135,000 overcharge for the respondents and Quaker, Ralston, and Nabisco for that period. The figures include a $207,817,000 overcharge attributed to General Foods even though, as found above (Findings 819–26), General Foods did not earn supracompetitive profits.

879. Kellogg's 16% price reduction on a single product in the year 1971 cannot be interpreted as a reflection of 16% monopoly profits on that product. It certainly cannot be interpreted to mean **[243]**that Kellogg was earning 16% monopoly profits on all products from 1958 through 1972; and most certainty it cannot be interpreted to mean that the five other largest firms in the industry were earning 16% monopoly profits on all of their branded items.

880. Complaint counsel next (CPF 11–215 thru 11–221) would apply the 3.8% advertising to sales ratio found by economist Stanley Ornstein for 87 consumer goods industries (see *supra,* Finding 847) to the RTE cereal industry, and conclude that all advertising in excess of the figure was wasteful. Having already found (*supra,* Findings 847–77) that it would be inappropriate to compare the RTE cereal industry's A/S ratio with the 3.8% figure and that there is a lack of proof that advertising in the RTE cereal industry is wasteful, complaint counsel's calculations are meaningless.

881. Finally, complaint counsel's attempts (CPF 11–222 thru 11–230) to calculate the extent of alleged supranormal profits on the

basis of its already rejected accounting and economic rates of return in relationship to a benchmark are similarly rejected. [244]

SUMMARY AND FURTHER DISCUSSION

Complaint counsel advance two grounds for asserting that respondents have violated Section 5 of the Federal Trade Commission Act: (1) Conspiracy; and (2) Acts and practices of respondents and economic performance of respondents and the RTE cereal industry, under a shared monopoly industry structure.

The complaint as issued failed to charge a conspiracy and was never amended to encompass that charge. While the ALJ before whom the case was then being heard allowed complaint counsel to proceed under a conspiracy theory, respondents never consented to this. The issue of conspiracy, therefore, many not be deemed to have been raised under the concept of conformance to the evidence under Section 315(a)(2) of the Commission's Rules of Practice, which requires that the issue be within the scope of the complaint and be tried with the consent of the parties. Respondents, therefore, may not be found to have violated Section 5 by reason of conspiracy.

Notwithstanding this holding, in consideration of the fact that this case was allowed to be tried under a conspiracy theory and in light of the unusually long time it has taken to try this case and the voluminous record that has been compiled, I have made all findings called for by the evidence, including those relating to the issue of conspiracy.

In any event, complaint counsel's case fails under either of its theories for lack of proof.

The factual issues, to a large extent, are common to both the conspiracy and the "shared monopoly" theories. Under the conspiracy theory, it was necessary for complaint counsel to establish that the respondents acted in particular noncompetitive fashion pursuant to agreement, express or tacit. Under the "shared monopoly" theory, many of the same acts and practices are asserted to be demonstrative, and an exercise, of respondents' alleged monopoly power.

While the oligopolistic structure of the RTE cereal industry is an essential element of complaint counsel's "shared monopoly" theory, respondents are not charged with violating Section 5 simply on account of the structure of the industry. Complaint counsel recognize that in an oligopolistic industry the members may be competitive or they may operate together in a monopolistic manner, so that, in addition to the structure of the industry, "a careful analysis . . . of

the conduct and performance of the sellers must be undertaken (CPF 6–17).

Complaint counsel assert that respondents avoided price and nonprice competition on RTE cereal products. Complaint counsel assert that each respondent is aware that it is to their mutual advantage to avoid competitive activities which can only bring about responsive competitive activities by their large rivals. The firms, therefore, avoid such competitive acts in accordance with understood rules of the game. **[245]**

On the issue of the avoidance of price competition, and in support of their structural approach, complaint counsel rely upon a generally accepted economic theory of Dr. Jesse W. Markham. That theory is to the effect that, in industries having certain characteristics, one would expect price leadership in lieu of overt collusion. One of the conditions required under Dr. Markham's theory, is that the commodity produced by the several firms be viewed by all of the firms as extremely close substitutes for each other. This condition is not met in the RTE cereal industry. To the contrary, there are many different types and categories of RTE cereals.[97]

"Price leadership" among clearly differentiated products is meaningless. It is necessary to have products sufficiently similar so that price is a primary element and can be coordinated by following a price leader. In this industry with differentiated products, it is not clear what there is to be coordinated. Price cannot be identified and isolated for particular products as something the sellers can focus on for purposes of coordination.

The RTE cereal industry, therefore, has not been shown as one in which price leadership in lieu of overt agreement is to be anticipated. Respondents' unlimited product competition with non-homogeneous products is inconsistent with a desire or effort to coordinate their activities and eliminate competition. To the extent they have proliferated products, they have engaged in a manner of competition that hinders and restrains coordination.

The record evidence pertaining to respondents' alleged price coordination is what might be expected from the above analysis of Dr. Markham's economic theory. A pricing pattern consistent with coordination was established with respect to only three sets of products—Kellogg's Corn Flakes and General Foods' Post Toasties; Kellogg's and General Foods' Raisin Brans; and Kellogg's Sugar Frosted Flakes and General Foods' Sugar Coated Corn Flakes. Other than for these three sets of similar products, there is no evidence of

[97] Another condition not established on this record is that individual firm cost curves must be sufficiently similar so that some particular price allows all firms to operate at a satisfactory rate of output.

price uniformity, maintenance of pricing levels, or pricing responses consistent with a pricing agreement or arrangement among respondents or with price leadership and followership.[98] For all [246]other products, the record tends to evidence a lack of brand price coordination or parallel pricing movement.

The evidence complaint counsel rely on to show a pattern of price leadership in lieu of overt collusion, with Kellogg being the price leader, consists of an analysis of pricing rounds in the industry covering 1965 through 1970, prepared and testified to by Dr. Scherer. As described by complaint counsel, "A price round is a series [or group] of list price changes that occur when a firm changes the price of two or more regular size branded products" (CPF 8–83). The lack of probative value of this analysis has been found as follows:

> Finding 265. The 16 price rounds, as presented by Dr. Scherer and relied upon by complaint counsel, do not take prices into account other than for the fact that price changes were made. Levels and magnitudes of price changes are ignored. Indeed, the price round presentation does not even demonstrate that "lead" price changes on particular products were followed by price changes on what may be termed directly competing products. To the contrary, the amount of price change varied by product, and the types of cereals involved in one company's price change varied from those in the subsequent price change of other companies. In short, there is no correlation of individual products or individual product prices in Dr. Scherer's price rounds. Indeed, individual products and prices are not even evaluated. There is, therefore, no showing of correlation of any brand prices or price differentials as to particular brands.

Dr. Scherer has conceded that, for most products, "there seems to be very little pattern in the relationships between changes in the price of one product relative to changes in the price of another" (Tr. 27,922).

In addition to the failure of the price rounds analysis to contain necessary product and pricing information, the rounds are inconsistent with price leadership-price followership. Kellogg, the alleged price leader, was not always first in announcing price [247]changes; and price changes by one respondent were not always followed by the others. Also, when a price change was followed, it was often only after a long delay.

Kellogg set prices for RTE cereals on the basis of a guideline for gross margins and a target net profit figure. It did not establish prices in order to maintain a profitable price structure for its RTE cereal competitors. The record reflects genuine, independent business reasons why General Mills and General Foods did not originate

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[98] Economists expect price similarity, even identity, for very similar products under competitive conditions. Price uniformity alone is insufficient to establish a price fixing conspiracy, since this may be the normal result of competition among similar products. *See, e.g., Morton Salt Co.* v. *United States*, 235 F.2d 573 (10th Cir. 1956); *FTC* v. *Lukens Steel Co.*, 454 F.Supp. 1182, 1190 (D.D.C. 1978).

price changes more frequently than they did and why they followed price increases of their competitors to the extent that they did.

Having failed to establish coordination on the part of respondents relative to the establishment, maintenance or change of prices for RTE cereals, complaint counsel have failed to prove (1) a price fixing conspiracy, or (2) noncompetitive pricing activity under a shared monopoly theory.

Complaint counsel assert that respondents have supported their pricing arrangement by refraining from indirect forms of price competition which might have spiraled into unrestrained price competition. These include trade deals, the use of cents-off labels, the insertion of in-pack premiums, and the production of private label cereals. Complaint counsel also assert that, while respondents offered discount coupons, their use was insignificant.

However, complaint counsel have failed to establish that respondents, either by agreement or by means of price leadership-price followership, fixed or coordinated list prices. There is, therefore, no price fixing arrangement shown, to be supported by refraining from indirect forms of price competition. In any event, the record fails to establish that respondents' activities with regard to indirect pricing activities were as a result of agreement or arrangement or flowed from the structural nature of the market. To the contrary, the record shows that, to the extent respondents acted similarly, each respondent reacted individually to common market conditions and the advent of television as a marketing device.

In addition to individual reactions to common marketing and advertising factors, respondents made independent decisions on the basis of their own situations. General Foods, for example, went through a period when it stressed a full line promotional approach. General Foods, accordingly, cut down on individual item promotions (including trade deals, cents-off labels and in-pack premiums). On the matter of production of private label products, neither General Mills nor Kellogg had the degree of excess capacity over an extended period of time that was required to enter into long term commitments to provide private label products. General Foods, on the other hand, had produced private label RTE cereal products since at least 1937 and attempted to expand its private label business. It discontinued private label only after it had suffered financial reverses and was unable to generate appropriate returns. Contrary to complaint **[248]**counsel's attempt to downplay respondent's utilization of coupons, couponing was widely used by respondents and they were redeemed by consumers at significant levels.

Complaint counsel have failed to establish that respondents'

indirect pricing activities were in accordance with any agreement, tacit or otherwise, or that respondents' activities reflected anything other than independent business decisions made in an effort to further legitimate business interests.

Complaint counsel assert that respondents avoided acts of non-price competition that might have led to price competition or that potentially might have threatened their goals of maintaining marketplace stability and maximizing profits.

Respondents exchanged advertising data through the A. C. Nielsen Co. Complaint counsel assert that this exchange of advertising information allowed respondents to prevent an expensive advertising war. However, there is no evidence that the respondents utilized the information to curtail or otherwise coordinate their advertising efforts. To the contrary, the record shows that industry members competed very strongly against each other in their advertising endeavors. Respondents' advertising expenditures followed markedly different and varying patterns both overall and on individual brands.

The complaint charged respondents with having maintained and utilized monopoly power. The exchange of advertising data was not alleged as a violation of law. Therefore, the failure to show that such an exchange was utilized for monopolistic purposes constitutes a failure of proof under the instant complaint.

Complaint counsel assert that respondents had a tacit agreement to avoid competition for shelf space in retail stores; that Kellogg formulated and implemented a shelf space allocation plan and General Mills and General Foods acquiesced in that plan. The assertion has no record basis.

Kellogg's shelving program advocated space according to sales and grouping by manufacturers. The program was unilaterally instituted by Kellogg to afford it a competitive advantage over other RTE cereal manufacturers, including the other respondents. There is no reason to believe that General Mills or General Foods was party to the institution or implementation of Kellogg's plan.

Retailers adopted Kellogg's recommendations because such recommendations served their own profitability and efficiency interests and were considered the most reasonable way of stocking RTE cereals.

Faced with Kellogg's shelving program which advocated space according to sales and grouping by manufacturers, which principles were logical and advantageous to retailers, as well as ones to which retailers were accustomed, it is not surprising that General Mills

and General Foods advocated the same guidelines when they competed for shelf space. **[249]**

While all three respondents generally advocated shelving by manufacturer and allocation of space according to volume, they each competed for all the space it could get. This included efforts to get more than a "fair share" of shelf space if its credibility would not be impaired by doing so. And each recommended the discontinuance of slow moving products of its competitors.

General Foods developed "Compact Packages" which were resized versions of existing cereal packages, designed to hold equivalent quantities of cereal in smaller boxes. General Foods thought this would enable it to acquire facings for additional items and would also add to its prestige as a leader in innovative shelving and so secure greater acceptance for its shelving recommendations. The program was a failure and General Foods lost shelf space as a result.

In 1971, General Foods developed and introduced C.O.M.P.A.S.S. (Customer Oriented Method of Profitability and Sales Service), a computerized system for making shelf space allocation recommendations on the basis of product profitability. However, retailers were not interested in the program.

Finding 490 summarizes the situation with respect to shelf space competition as follows:

> It is concluded, therefore, that the record does not support complaint counsel's assertion that respondents had a tacit agreement to avoid competition for shelf space in retail stores. Kellogg independently formulated a shelf space allocation plan that incorporated principles which were in accord with retailers' preferred methods of doing business. The other respondents, faced with the same requirements of retailers, responded with plans that incorporated the same basic principles. While each respondent competed for the most favorable shelf space location and the most space it could get, it was constrained not to push for more than a reasonable share in order to maintain rapport and credibility with retailers. Nevertheless, both General Mills and General Foods did present shelving alternatives and variations in an effort to gain competitive advantages.

Complaint counsel assert that respondents avoided widespread product fortification until outside pressure forced them to fortify their cereals; that fortification then occurred as a result of coordinated activity to ensure that no one of the respondents would gain a competitive advantage by introducing fortified products before the others. The record does not support complaint counsel's assertions of agreement and coordination. **[250]**

Prior to 1970, the Council on Foods and Nutrition of the American Medical Association and the Food and Nutrition Board of the National Research Council both recommended that nutrients be added to foods only to the extent of restoring what was lost during

the manufacturing process. During the mid-1960's, the Food and Drug Administration publicly opposed fortifying RTE cereals beyond allowable limits, on the ground that the availability of vitamins to consumers from other sources made cereal fortification unnecessary. The FDA proposed a rule and instituted rulemaking proceedings to so limit fortification.

Notwithstanding the pronouncements of the Council on Foods and Nutrition of the American Medical Association and the Food and Nutrition Board of the National Research Council and the adverse position of the FDA, respondents engaged in considerable fortification activity prior to 1970.

However, there was limited consumer demand for fortified RTE cereals during the 1960's and only limited, temporary success for products that were fortified. The record fails to indicate that respondents' individual competitive efforts prior to 1970 in the field of product fortification were not fully commensurate with the public demand. There is no evidence that indicates that respondents reached agreements concerning, or coordinated, their pre-1970 fortification conduct.

In the late 1960's and early 1970's, there was a dramatic change in the national attitude toward the fortification of cereals. A White House Conference on Nutrition issued a report in December 1969 to the effect that there were significant nutritional deficiences in the diets of large segments of the population. It recommended that the proposed 1966 FDA regulations barring the fortification of breakfast cereals not be adopted, because the widespread acceptance and consumption of breakfast cereals made them effective carriers of essential nutrients. It attacked the view that all needed nutrients were obtained from ordinary diets, and recommended strong food fortification programs. Consequently, the FDA abandoned its proposed rule to prohibit food fortification.

In July 1970, Mr. Robert B. Choate, in testimony before a congressional committee, criticized the lack of nutrients in RTE cereals. Mr. Choate's testimony was widely publicized and further increased industry and consumer interest in vitamin fortification.

Following the White House Conference on Nutrition report, the FDA reversal of position and the Choate testimony, the respondents became very heavily engaged in product fortification. Respondents' activities, however, were fully consistent with individual, competitive responses to stated public policy and consumer interest and demand.

While the respondents attended two meetings of the Cereal Institute shortly after Choate's testimony, respondents did not [251]

discuss plans regarding fortification at either meeting. No agreements were there made regarding fortification. There is no evidence that the respondents otherwise communicated regarding their fortification activity, or that any respondent had advance knowledge of the fortification plans of the others.

There is no basis, therefore, for an inference that respondents' fortification activities, which were most reasonable in the light of ongoing events, were in response to an otherwise unproved agreement rather than the ongoing events.

Complaint counsel assert that the RTE cereal industry is marked by high barriers to the entry of new firms and that there are no barriers to entry unrelated to respondents' conduct. The conduct so targeted by complaint counsel is brand proliferation which is asserted to provide the complete answer to lack of entry.

It is complaint counsel's position that respondents' avoidance of competition by other means led them to turn to brand proliferation, the introduction of a large number of differentiated, highly advertised trademarked brands; that, while brand proliferation is not in itself unlawful, respondents must be held responsible for its deterrent effects upon entry, since respondents turned to this method of competition as a result of their mutual avoidance of other means of competition.

Brand proliferation is nothing more than the introduction of new brands which is a legitimate means of competition. Respondents' brand proliferation is vigorously competitive and, as conceded by complaint counsel, is not predatory and not in itself unlawful. Respondents engaged in intense, unrestrained and uncoordinated competition in the introduction of new products. There is no evidence of a conspiracy or intent to deter entry by means of new product introductions.

Consumers' desire for variety for breakfast is responsible, in large measure, for the differentiation of RTE cereals. A firm in the RTE cereal industry must introduce new products in order to remain profitable and compete for market share.

Respondents, therefore, may not be held responsible for the results of this legitimate method of competition, unless it was the proximate result of their having otherwise limited their competitive efforts as charged. However, complaint counsel failed to prove those charges. Further, even if respondents had conspired or otherwise unlawfully coordinated their other competitive efforts, new product introduction would still have remained as a legitimate means of competition. No causal relationship has been shown between the alleged avoid-

ance of other methods of competition and competition by brand introduction.

This fully disposes of complaint counsel's effort to hold respondents liable under Section 5 by reason of having engaged in new [252]brand competition (proliferation). However, in order to provide complete findings for a reviewing authority, I examined complaint counsel's analysis of how brand proliferation allegedly created a barrier to entry and made numerous findings with respect to various steps in complaint counsel's theory. Without here repeating all of the elements of complaint counsel's theory and all of the findings, following is a reference to some of the more dispositive findings.

One of the requisite elements of the proliferation theory is that the market be localized or segmented so that each cereal competes almost exclusively in its own limited segment.

There are segments or categories of cereals which compete more strongly with each other because of their similar attributes. There are some cereals that are so similar that they compete with each other on a one to one basis. At the same time, some cereals may have a broader appeal than the particular segment or category they may fall in so that they compete to varying degrees with cereals outside of their particular category. The record, however, does not permit a delineation of the segments and the degrees to which competition among cereals is confined to cereals in particular segments or extends beyond such segments. The extent of the impact of localization, therefore, is unknown.

Complaint counsel assert that proliferation has crowded some segments to the extent that there is not sufficient opportunity for a new product. While crowding has undoubtedly deterred new entry into some areas, the areas so precluded, their economic significance, and the time periods of preclusion have not been identified.

Complaint counsel's assertion that the introduction of all of the products that can profitably compete in an area will dissuade the entry of still more products is not at all disturbing. It is just another way of saying that competition will deter entry and the more vigorous the competition, the more likely it is that new entry will be deterred. Complaint counsel have merely evidenced and analyzed how competition by existing firms in the form of new products will deter the introduction of still more products by new entrants.

There is a product efficiency of scale equal to about 1% of the market. Complaint counsel assert that firm efficiency of scale is not reached until sales of 3.5% to 5% of the market are achieved. It is argued that respondents, all of whom are already operating at or above firm efficiency of scale, can introduce a new product whenever

a 1% opportunity appears, whereas an outsider cannot; that an outsider is faced with the insurmountable task of finding and expensing three or more opportunities in order to enter the market at minimum firm economy of scale, so as not to be at a cost disadvantage to respondents.

Evidence of probative value on the issue of firm efficiency or economies of scale was found to be limited to a "Headen-McKie" study. Findings 629 and 641 pertain to the Headen-McKie report: [253]

629. The Headen-McKie conclusions on firm economies of scale have no analytical or other substantive support. As conclusions drawn from conversations with production managers, and limited to production costs, they are at best a rough estimate that firm economies of scale are not fully realized until a 5% market share is reached. However, the report does not indicate the difference in production efficiencies at the 1% and 5% levels or for points in between. Accepting the report at full value, it may be that, while firm economies of scale are fully realized at the 5% level, there is not a significant difference in firm efficiencies at the 1% and 5% levels.

641. In summary, under Headen-McKie, which does provide a rough estimate of production scale economies, it would be economically feasible to enter the RTE cereal market with production facilities capable of supplying about 1% of the national market. While the entrant could earn "satisfactory" profits at that level of production, it would not achieve full production economies of scale unless it supplied about 5% of the market. The study, however, does not indicate the degree of disadvantage that a firm would be under at various levels of production below 5% down to 1%. Even if a firm required 5% of the market to achieve minimum efficient scale, it would enter at a smaller volume if the cost disadvantage was not too great. It is impossible, therefore, to evaluate the extent to which preemption of new entrants by reason of their inability to achieve economies of scale has acted to deter entry (footnotes ommitted).

While brand proliferation may well exert a deterrence on entry,[99] it is not the only deterrence. The situation has been summarized as follows in Findings 668–74:

668. Respondents have engaged in intense, uncoordinated competition in the introduction of new [254]products. This competition is not unlawful nor was it induced by other unlawful activity.

669. Obviously, the more successful new products introduced by respondents and other incumbents, the more saturated the market and the less requirement and opportunity for the introduction of new products by outsiders. By the very nature of differences in demand (*e.g.*, presweets, natural, fortified, bran, flavored), products are to a degree localized, and a new product would to a degree be limited as to the segment from which it could attract its users. Individual products account for lower market

[99] As noted above, the extent to which lack of entry in the RTE cereal industry may be explained by brand proliferation is an unknown quantity, because of a failure of proof of two of the elements upon which the theory rests. These are: (1) minimum firm efficient scale of entrance below which the new entrant would be at a significant competitive disadvantage to existing firms and (2) the degree of localization of RTE cereal products.

shares and smaller poundage of sales than formerly. The industry has become one of relatively small volume brands.

670. Incumbents are at an advantage over potential entrants in developing and marketing acceptable new products. They can utilize existing research and development, market research and other expertise in locating opportunities and developing products to meet perceived demand. They can also utilize unused capacity for production of a new brand, whereas a new entrant would have to build that capacity.

671. Respondents and other incumbents are not only capable of finding and taking advantage of an opportunity before a potential new entrant, but, because of economies of scale, are in a position to take advantage of smaller opportunities.

672. Would be entrants are faced with substantial fixed costs in research and development, market research, plant production equipment and introductory advertising. To the extent the requirement exists to introduce multiple products, the costs would multiply. Potential entrants, therefore, are limited to large firms, primarily those already producing and supplying grocery products who can utilize their existing expertise and so minimize costs of entry and operation.

673. The limited number of potential entrants would exercise caution in actually entering because of high capital costs, long lead times in developing and marketing acceptable products, extended periods even after entry in reaching levels of profitable operation and recovering capital investments, and the high risk that a product may prove unacceptable at various stages up to national entry or may fail after entry. Indeed, the problems of developing an acceptable product with which to enter may be insurmountable.

674. While potential entrants would be aware of the publicly reported profitability of Kellogg, they could not hope to emulate the most successful company. Their desire [255]to enter would be tempered by their observation of others in the industry. They would hesitate knowing of the failure of General Foods in marketing its cereals with fruit and its loss of market share, and of Nabisco's decline in market share. Potential entrants would also hesitate because of the observed inability of Pillsbury, Colgate, International Multifoods, and H.J. Heinz to remain in the market and the limited success of Pet.

Basic to complaint counsel's shared monopoly theory is the allegation that respondents have maintained a pattern of conduct that has enabled them to charge supracompetitive prices and to reap monopoly level profits; and that this demonstrates that they are sharing monopoly power. Complaint counsel have stated, "However, proof of monopoly power in this case rests primarily on the evidence that each of the respondents gained monopoly profits over a long period of time." Complaint counsel's theory of the existence of a barrier to entry into the RTE cereal industry is also premised, in part, on the assertion that the industry has enjoyed supracompetitive profits.

Complaint counsel have elected to measure and evaluate profits in terms of rates of return on capital employed. This is an appropriate means of measuring profits for purposes of this case and is preferable to other measures, such as return on equity or return on sales.

There are significant differences between accounting and economic rates of return. Upon an analysis of those differences and the

nature of the RTE cereal industry, it has been found that economic rate of return, not accounting rate of return, is the appropriate measure to be used in appraising profits enjoyed in the RTE cereal industry and in making comparisons among respondents, with other companies and with other industries.

Dr. Thomas R. Stauffer has devised a formula to determine the economic rate of return for an ongoing firm. This formula is a pioneering contribution in the field and was the subject of Dr. Stauffer's doctoral dissertation in economics at Harvard University. Other doctoral dissertations in economics at Harvard have applied his formula in the analyses of specific industries. The formula was applied by Dr. Stauffer in the instant case.

Dr. Stauffer's formula starts with an accounting rate of return and from it calculates an economic rate of return. In order to determine General Mills' and General Foods' accounting rate of return for RTE cereal, it was necessary to segregate and allocate portions of overall company accounting data covering multifacets of those companies' businesses that pertained to the RTE cereal segment of the company. Once this was done, there were various unknowns in the formula used to convert accounting rates of return to economic rates of return which had to be estimated. The results were then compared with a benchmark—the average economic rate of return on capital **[256]**employed for all firms in the manufacturing sector of the United States.

After applying allowable allocations to general company accounting data to reach accounting rates of return for RTE cereal, utilizing allowable estimates for the unknown factors in Dr. Stauffer's conversion formula, and adjusting the benchmark rate of return to exclude data for manufacturing companies which had no income, the following economic rates of return were arrived at:

	Kellogg	General Mills	General Foods	Ralston	Benchmark
1958–1970	11.7	10.5	7.3	9.9	10.3
1954–1972	13.2	10.1	6.7	10.7	10.1

This is not a finding of what respondents' and Ralston's economic rates of return have been, but rather that there is a lack of proof of any higher returns.

Probably because of the fact that Quaker's rate of growth exceeded its rate of return, Dr. Stauffer's formula was inappropriate to estimate Quaker's economic rate of return; and there is no record

evidence of that rate. There is record basis, however, for assuming that it was well below 9%, *i.e.*, well below the benchmark. The record also independently establishes that General Foods did not earn above-normal (supracompetitive) profits.

There are a number of considerations which bias the benchmark downward, *i.e.*, understate the average profits of the manufacturing sector when comparing them with the profits of RTE cereal companies. Two important factors that must be considered before meaningful comparisons may be made between RTE cereal companies' rates of return and the benchmark are (1) inflation and (2) risk.

Dr. Stauffer made no adjustments for inflation, since he was not trying to compute absolute levels of profitability, but rather to compare relative levels. However, the failure to account for inflation caused a greater upward bias on the computation of profits of the RTE cereal firms than on the benchmark.

A higher than average return is still considered competitive or normal if the amount above the average is compensation for above average risk. A normal rate of return for a business with above average risk would be greater than for less risky businesses. RTE cereal is a relatively high risk industry.

Thus, it has been found:

Finding 815. The benchmark derived from IRS data for the manufacturing sector cannot be deemed to **[257]**draw an absolute line of demarcation between normal and monopoly profits. While such IRS data have generally been relied upon by economists, there is concedely some degree of inexactitude (citations omitted; and note the various biases enumerated above). Further, the benchmark is simply an average of firms' earnings below the average and firms' earnings above the average. It cannot be said that every firm earning above average, whose rate of return contributed to reaching the average, is earning monopoly profits. Finally, while not quantified, considerations of inflation and risk establish a normal rate of return for the RTE cereal respondents at a somewhat higher level than an average benchmark.

Finding 816. In consideration of the above, while the benchmark may be used as a rough guideline to aid in evaluating rates of return, a rate of return cannot be said to be monopolistic or supracompetitive unless it is substantially in excess of the benchmark. That is not the case here. General Foods' rate of return is substantially below the benchmark. Quaker's return may be assumed to be below it (Finding 796). General Mills' and Ralston's rates of return approximate it. Only Kellogg is shown to have a rate of return in excess of the benchmark; and, in consideration of the variables and biases discussed above, its rate cannot be said to be substantially in excess.

Thus, complaint counsel's factual assertion basic to its shared monopoly theory, that respondents and others in the RTE cereal industry realized supracompetitive profits, fails for lack of proof.

Complaint counsel assert that respondents have not been innovative in their efforts to bring new and better products to consumers;

that their new product developments have been essentially variations of existing RTE cereal products rather than innovations.

Complaint counsel are thus raising a question of the consumer welfare significance of new product introductions. This is not a matter for my judgment in this case. Any product that expands the choices of a consumer is an innovation. The significance of an innovation is determined by its success in the marketplace. As stated in Finding 840:

> There is no reason to believe that respondents have not attempted to come up with all reasonable innovations consistent with anticipated consumer acceptance. Neither complaint counsel nor I are in a position to pass judgment on what, if any, additional significant innovations the industry could or should have come up with. It cannot be found that [258]something more dramatic should have been developed, or that there are areas where innovativeness was neglected. The only area specifically alleged by complaint counsel to have been neglected is that of product fortification, and that allegation has been found to be unsubstantiated (footnote omitted).

Complaint counsel assert that advertising cost levels in the RTE cereal industry are excessive and wasteful. While the advertising-to-sales ratio for the RTE cereal industry is almost at the top of all manufacturing industries, RTE cereal industry advertising cannot be found to be excessive.

Advertising performs a necessary and legitimate function of advising prospective customers of the attributes of products offered for sale. The large number of nonhomogeneous RTE cereal products, each with its requirement for separate advertising, dictates a relatively high A/S ratio. This requirement is further impacted by the high incidence of new product introduction which necessitates high levels of advertising.

It may well be that levels of advertising, to some extent, are being raised to achieve additional returns depending on the gross profit margins being realized (the Dorfman-Steiner principle). However, it is not improper for a manufacturer to increase advertising to the point of realizing all possible marginal returns. In the absence of a showing that respondents were earning supracompetitive profits, their advertising levels, even to the extent they may be based on marginal returns, cannot be termed inefficient or wasteful.

As summarized in Finding 870:

> . . . I start with the basic assumption that advertising is a viable and legitimate method of competition. And complaint counsel have failed to demonstrate that the large volume of advertising in the RTE cereal industry does not have a competitive basis or that it reflects the existence of supracompetitive profits. A firm advertises in order to generate or increase sales and so increase profits. At the same time, once profits are realized, or in anticipation of profits, the firm may increase advertising up to the point of realizing all possible marginal returns. This, however, is pure theory

and no findings can be made as to the extent respondents have increased normally competitive advertising levels to take advantage of the Dorfman-Steiner principle.

It is not appropriate to mandate a "socially optimal level" of advertising as a substitute for one reached as a result of [259] competitive considerations. Our concept of a free competitive system does not envision imposition by government of permissible levels of advertising.

To establish the existence of a conspiracy to monopolize, the following elements are necessary: (1) the existence of a combination or conspiracy; (2) overt acts done in furtherance of the combination or conspiracy; (3) an effect upon a substantial amount of interstate commerce; and (4) the existence of specific intent to monopolize. *Cullum Electric & Mechanical Inc.* v. *Mechanical Contractors Association of South Carolina,* 436 F.Supp. 418, 425 (D.S.C. 1976), *aff'd,* 569 F.2d 821 (4th Cir. 1978), *cert. denied,* 439 U.S. 910 (1978).

Conspiracy is an agreement by two or more persons to pursue a common goal or objective having an unlawful purpose. *Standard Oil Co. of California* v. *Moore,* 251 F.2d 188, 196 n. 3 (9th Cir. 1957), *cert. denied,* 356 U.S. 975 (1958). However, a conspiracy need not be demonstrated by evidence of an express agreement. *Comfort Trane Air Conditioning Co.* v. *Trane Co.,* 592 F.2d 1373 (5th Cir. 1979); *FTC* v. *Lukens Steel Co.,* 454 F.Supp. 1182 (D.D.C. 1978). Direct evidence is not required because of the general recognition that:

. . . seldom are the conspiratorial villains so devoid of cleverness as to broadcast their oral agreements or publicly circulate the written memos which describe their plan.

Rutledge v. *Electric Hose and Rubber Co.,* 327 F. Supp. 1267, 1274 (C.D. Ca. 1971), *aff'd,* 511 F.2d 668 (9th Cir. 1975).

While the essence of conspiracy is agreement or a "meeting of the minds," tacit understanding can be found by mere acquiescence or acceptance of an invitation to participate in a plan, if each competitor knows that cooperation is essential to the success of the plan. *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Wall Products Co.* v. *National Gypsum Co.,* 326 F. Supp. 295, 316 (N.D. Ca. 1971). If people with knowledge give adherence to a plan, acquiescence is sufficient to establish a tacit agreement.

Tacit agreement can be inferred from circumstantial evidence of conduct or a course of dealing even though there is no evidence of the acts by which the conspiracy was formed. *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Overseas Motors, Inc.* v. *Import Motors Limited, Inc.,* 375 F. Supp. 499 (E.D. Mich. 1974), *cert. denied,* 423 U.S. 987 (1975).

The use of circumstantial evidence to infer a conspiracy presents

problems of proof. The evidence must create more than a suspicion of wrongdoing. *Admiral Theatre Corp.* v. *Douglas Theater Co.,* 585 F.2d 877, 884 (8th Cir. 1978). As stated in *Overseas Motors, Inc.* v. *Import Motors Limited, Inc.,* 375 F. Supp. at 531: **[260]**

> There is a limit, however, to the degree of indirection and innuendo which the law will tolerate. Where . . . the plaintiff's case is based entirely on such circumstantial evidence, the court must be especially vigilant to insure that liberal modes of proof do not become the pretext for unfounded speculation.

Therefore, courts are cautious and consider the circumstantial evidence as a whole rather than viewing it in isolation. *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946); *Continental Ore Co.* v. *Union Carbide & Carbon Co.,* 370 U.S. 690, 699 (1962).

Consciously parallel conduct is circumstantial evidence that competitors have acted pursuant to a tacit agreement. Standing alone, however, parallel business behavior does not constitute violation of the antitrust laws. The Supreme Court has stated that:

> . . . this Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense. Circumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy; but "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely (footnote omitted).

Theatre Enterprises, Inc. v. *Paramount Film Distributing Corp.,* 346 U.S. 537, 541 (1954).

The fact that conduct is parallel or occurred near in time may be an independent response to a common set of market factors. The coincidence of parallel decisionmaking does not justify inference of tacit agreement if action is based on sound business judgment. *Schoenkopf* v. *Brown & Williamson Tobacco Corp.,* 483 F. Supp. 1185, 1191 (E.D. Pa. 1980), *aff'd,* 637 F.2d 205 (3rd Cir. 1980); *Hunt* v. *Mobil Oil Corp.,* 465 F. Supp. 195, 228–29 (S.D.N.Y. 1978), *aff'd,* 610 F.2d 806 (2nd Cir. 1979); *Harlem River Consumers Cooperative, Inc.* v. *Associated Grocers of Harlem, Inc.,* 408 F. Supp. 1251, 1278 (S.D.N.Y. 1976). As stated in *Independent Iron Works, Inc.* v. *United States Steel Corp.,* 177 F. Supp. 743, 747 (N.D. Ca. 1959), *aff'd,* 322 F.2d 656 (9th Cir. 1963), *cert. denied,* 375 U.S. 922 (1963):

> The antitrust laws were not meant to prohibit businessmen from adopting sound business policies **[261]**merely because competitors had already adopted the same or similar policy.

As with other parallel conduct, uniformity of price, without more, is not evidence of collusion. *See United States* v. *FMC Corp.,* 306 F.

Supp. 1106, 1117 (E.D. Pa. 1969). Mere leadership or price followership based on independent decisionmaking violates no law. *United States* v. *International Harvester Co.,* 275 U.S. 693, 708–09 (1927).

Thus, it has been held that price uniformity alone is insufficient to establish an antitrust violation because it may be the normal result where a product is standardized or fungible, even though there is no agreement between competitors and the costs for the participating companies are not the same. *See FTC* v. *Lukens Steel Co.,* 454 F. Supp. at 1190. Where there is an oligopoly involved in the production of a standardized product, such as salt, for which the demand is stable, it is inevitable that pricing policies of one company would influence the other. Therefore, other factors should be considered in addition to the parallel pricing. *See, e.g., Morton Salt Co.* v. *United States,* 235 F.2d 573 (10th Cir. 1956).

Because evidence of parallel business behavior alone is not sufficient to support an inference of conspiracy, courts have required additional factors to show that the parallel decisions were interdependent. *See Levitch* v. *Columbia Broadcasting System, Inc.,* 495 F. Supp. 649, 674 (S.D.N.Y. 1980). The additional circumstances which support the inference are: (1) a showing that the acts by defendants are in contradiction to their own economic interests and (2) a satisfactory demonstration of a motivation to enter an agreement. *Venzie Corp.* v. *United States Mineral Products Co.,* 521 F.2d 1309, 1314 (3rd Cir. 1975).

Action against apparent individual self-interest is a strong indication of interdependence and tacit agreement among competitors. *Modern Home Institute Inc.* v. *Hartford Accident and Indemnity Co.,* 513 F.2d 102, 111 (2nd Cir. 1975). Parallel conduct which is complex, original, unanimous or corresponds exactly, especially where it is an abnormal reaction to market stimuli and inconsistent with each company's economic self-interest, strengthens the inference. *Overseas Motors, Inc.* v. *Import Motors Limited, Inc.,* 375 F. Supp. at 535; *Trist* v. *First Federal Savings and Loan Association of Chester,* 466 F. Supp. 578, 581 (E.D. Pa. 1979).

Motive to enter an agreement can be inferred from a pattern of conduct and can reasonably be drawn from the facts presented. *First National Bank of Arizona* v. *Cities Services Co.,* 391 U.S. 253, 287 (1968); *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946). Proof of motivation is evidence which makes "the inference of rational, independent choice less attractive than that of concerted action." *Bogosian* v. *Gulf Oil Corp.,* 561 F.2d 434, 446 (3rd Cir. 1977), *cert. denied,* 434 U.S. 1086 (1978). **[262]**

The ultimate determination is whether the evidence reveals

conduct that can be explained by rational, independent business behavior or could only make sense in the context of the behavior of others. If the letter is true and the behavior only makes sense if each respondent's competitors behave in a similar fashion, then the inference of concerted action may be warranted. *FTC* v. *Lukens Steel Co.,* 454 F. Supp. at 1191. However, circumstantial evidence is not sufficient to establish a conclusion where the circumstances are merely consistent with such a conclusion or where they give equal support to inconsistent conclusions. *Pevely Dairy Co.* v. *United States,* 178 F.2d 363, 370 (8th Cir. 1949), *cert denied,* 339 U.S. 942 (1949).

If the proof supports the inference of tacit agreement, the burden then rests on respondents to explain it away or to contradict it. *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Milgram* v. *Loew's, Inc.,* 192 F.2d 579, 584 (3rd Cir. 1951), *cert. denied,* 343 U.S. 929 (1952). The inference can be overcome where there is direct evidence that the action was taken unilaterally for sound business reasons. *See, e.g., Feminist Women's Health Center, Inc.* v. *Mohammad,* 586 F.2d 530, 549 (5th Cir. 1978), *cert. denied,* 444 U.S. 924 (1979).

In considering the implications of the respondents' behavior, it is important to stress the Supreme Court's admonition that:

> . . . each case arising under the Sherman Act must be determined on the particular facts disclosed by the record, and that the opinions in those cases must be read in the light of their facts and of a clear recognition of the essential differences in the facts of those cases, and in the facts of any new case to which the rule of earlier decisions is to be applied.

Maple Flooring Manufacturers Ass'n v. *United States,* 268 U.S. 563, 579 (1925).

In the instant case, there has been a total failure to demonstrate pricing coordination among respondents. There is, therefore, no coordinated pricing activity concerning which the possibility of tacit agreement may be considered.

Complaint counsel have failed to prove the alleged coordination or agreement among respondents with respect to trade deals, cents-off deals, in-pack premiums, private labeling, advertising, competition for retail shelf space or fortification of cereals. In any event, respondents have established that their actions were independent responses to similar economic and market conditions or to particular conditions facing an individual respondent. **[263]**

The only coordinated activity alleged and proved was the exchange of advertising data. However, the data so acquired were not utilized in a noncompetitive fashion. The exchange of nonprice information

alone is not a violation of the Sherman Act. *FTC* v. *Lukens Steel Co.,* 454 F. Supp. at 1191–92. *See Maple Flooring Manufacturers Ass'n* v. *United States,* 268 U.S. 563, 582 (1925).

It has been concluded, therefore, that respondents did not violate Section 5 of the Federal Trade Commission Act by reason of conspiracy.

Complaint counsel have presented their shared monopoly theory under a structure-conduct-performance approach, and have conceded that an oligopolistic structure alone does not constitute a violation of Section 5; that it is also necessary to show the existence and exercise of monopoly power.

Structure consists of two elements: (1) degree of concentration and (2) extent of barriers to entry. The RTE cereal industry is one of the most highly concentrated industries in the United States. However, there has been a failure of proof that the industry members have been enjoying monopoly profits, a condition under which it may be argued that there would have been entry if there were no barriers to entry. Further, it has been found that respondents may not be held responsible for the lack of entry into the RTE cereal industry.

As for conduct, there has been a lack of proof that respondents have engaged in the coordinated conduct alleged as part of complaint counsel's theory of violation.

This brings us finally to performance where complaint counsel have failed to prove the monopolistic performance alleged as part of their theory of violation, *i.e.,* that respondents earned supracompetitive or monopoly profits; that respondents have not been innovative in new product development; that respondents have been wasteful in advertising expenditures; and that respondents' prices have been so high that there has been a lessened demand for and supply of RTE cereals with a resultant waste and misallocation of society's resources.

Section 5 of the Federal Trade Commission Act was designed to reach unfair methods of competition which do not achieve the level of Sherman Act violaions. *FTC* v. *Motion Picture Advertising Service Co.,* 334 U.S. 392 (1953); *Fashion Originators' Guild of America, Inc.,* v. *FTC,* 312 U.S. 457 (1941); *FTC* v. *Cement Institute,* 333 U.S. 683 (1948).

The scope of Section 5 is not bound by Section 2 of the Sherman Act. Therefore, conduct which threatens an incipient violation of **[264]**the Sherman Act can amount to a Section 5 violation. *See, e.g.,*

L.G. Balfour Co. v. *FTC,* 442 F.2d 1 (7th Cir. 1971); *Borden, Inc.,* 92 F.T.C. 669, 781 n. 4 (1978). The Supreme Court has stated that the Federal Trade Commission has "authority to consider public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws." *FTC* v. *Sperry & Hutchinson Co.,* 405 U.S. 233, 244 (1972).

The Supreme Court has set some parameters as to what kinds of commercial conduct can constitute a Section 5 violation, declaring:

> The point where a method of competition becomes 'unfair' within the meaning of the act will often turn on the exigencies of a particular situation, trade practices, or the practical requirements of the business in question.

FTC v. *Motion Picture Advertising Service Co.,* 344 U.S. 392, 396 (1953).

Conduct has been found to be unfair in violation of Section 5 if it has the effect of increasing monopoly power to the detriment of competition. *See, e.g, Sugar Institute, Inc.* v. *United States,* 297 U.S. 553, 598 (1936); *Maple Flooring Manufacturers Ass'n* v. *United States,* 268 U.S. 563, 586 (1925). As Administrative Law Judge Brown has recently stated:

> Section 5 of the Federal Trade Commission Act can be invoked to effect structural changes in an industry only where it is clearly demonstrated that the competitive disequilibrium is the result of some conduct that could be designated as 'unfair.' If the challenged conduct is not unreasonable and not the cause of the trend toward monopoly power, no violation of Section 5 exists, merely because the effects upon competition may be undesirable from an economic point of view.

E. I. DuPont de Nemours, 3 Trade Reg. Rep. ¶ 21,613 at 21,750, *aff'd,* by the Commission, ¶ 21,770 (1980).

In *Boise Cascade Corp.* v. *FTC,* 637 F.2d 573 (9th Cir. 1980), the court considered whether industrywide use of a delivered pricing system was a collusive practice to fix prices and whether it could be condemned under Section 5. The court refused to resolve the question whether conscious parallelism might ever support a Section 5 violation. However, it did find that: **[265]**

> . . . in the absence of evidence of overt agreement to . . . avoid price competition, the Commission must demonstrate that the challenged pricing system has actually had the effect of fixing or stabilizing prices. Without such effect, a mere showing of parallel action will not establish a Section 5 violation.

Id. at 577.

Finally, the court noted that:

> . . . where the parties agree that the practice was a natural and competitive development in the emergence of the southern plywood industry, and where there is a

complete absence of evidence implying overt conspiracy, to allow a finding of a Section 5 violation on the theory that the mere widespread use of the practice makes it an incipient threat to competition would be to blur the distinction between guilty and innocent commercial behavior.

Id. at 582.

It would serve no purpose to consider in a vacuum what factual showing, if any, of industry structure, conduct and performance would constitute a "shared monopoly" violation of Section 5, and might justify an order restructuring an industry. Such a showing has not been made here.

FINAL CONCLUSIONS OF LAW

1. Respondents Kellogg Company, General Mills, Inc. and General Foods Corporation were, at all times material herein, corporations engaged in commerce, as "commerce" is defined in the Federal Trade Commission Act.

2. The complaint does not encompass a charge of conspiracy. Counsel supporting the complaint have failed to sustain, the burden of establishing that respondents, or any of them, have violated Section 5 of the Federal Trade Commission Act. This finding of failure of proof relates, *inter alia,* to the issue of conspiracy, which was tried though not covered by the complaint. **[266]**

ORDER

It is ordered, That the complaint in this proceeding be, and it hereby is, dismissed as to all respondents.

ORDER DENYING APPEAL AND VACATING INITIAL DECISION

The Commission has determined not to hear further appeal of this matter. The Commission has also determined that the Initial Decision shall not become the final decision of the Commission. Thus,

It is ordered, That, the Initial Decision in Docket No. 8883 be vacated in its entirety, and the Commission's complaint in this matter be, and it hereby is, dismissed with prejudice.

Commissioner Pertschuk dissented as to denial of the appeal.

SEPARATE STATEMENT OF COMMISSIONER CLANTON

This case raises important issues concerning the application of Section 5 of the FTC Act to oligopolistic conduct. Because of these

issues and the present posture of this case—Administrative Law Judge Berman's decision in favor of respondents coupled with the Bureau Director's decision not to appeal—it seems highly desirable for the Commission to determine now whether a full briefing on the merits is warranted.

Of course, even in the absence of an appeal, the Commission has the right under Section 3.53 of the Rules of Practice to undertake a thorough review of the record. However, I believe the circumstances of this case justify an exception to that practice. Given the theories of liability and proposed relief under consideration, it is entirely proper for us to see if there is a likely basis for issuing an order, even if the facts conform closely to what complaint counsel contend.

After having reviewed the parties' most recent submissions, in response to the Commission's order of December 18, 1981, as well as other parts of the record, I cannot find a basis for continuing the case. In its most succinct form, complaint counsel urge that liability be premised on the basis of two related but distinct theories. The first is a traditional conspiracy to monopolize based upon the principles contained in Section 2 of the Sherman Act; the second is a shared monopoly theory under Section 5 of the FTC Act, a theory which does not depend upon a showing of collusion. Under either of these theories, complaint counsel argue that the only effective form of relief would be a divestiture order, including royalty-free licensing of respondents' cereal trademarks.

As to the first theory, I agree with ALJ Berman that a conspiracy to monopolize was not properly pled. As for the separate shared monopoly theory, I do not believe such a theory, however characterized, can serve as a predicate for the Commission to restructure an industry, at least in the absence of clear predatory behavior, which is not claimed here.

I do want to emphasize, however, that Section 5 may well provide the Commission with sufficient authority to attack non-collusive behavior that contributes to or enhances anticompetitive conduct, and which is without compelling business justification. In such circumstances, the principal remedial tool for dealing with this kind of behavior would be a conduct order. [2]

Before elaborating further on these points, I would offer a comment about the characterizations, or mischaracterizations, that have been advanced in the past by critics of this case. An awful lot of rhetoric has been spilled on this subject, with some critics claiming that the case is just the first step in a broad-based attack on concentrated industries. Others have accused the agency of attacking competitive forms of behavior, such as product differentiation

and brand proliferation; while still others have derided the "shared monopoly" concept, suggesting that this is evidence alone of the Commission's confused thinking since the description itself is a contradiction in terms.

Suffice it to say, I do not share all of the views of the critics of this case. In issuing the complaint, I think the Commission sought to address a legitimate concern, not about oligopolies *per se,* but rather about oligopolistic behavior that is uniquely anticompetitive. Respected antitrust commentators of different persuasions—such as Professor Posner and Professors Areeda and Turner—have advocated different approaches for dealing with collusive-type behavior among oligopolists.[1] Whether the theories of relief proposed by complaint counsel are proper is one thing, but it is clear to me that the Commission was not attempting through this case to challenge structure or bigness *per se.*

Conspiracy to Monopolize

As one of their principal prongs of liability, complaint counsel now contend that an implied conspiracy to monopolize can be inferred from respondents' course of dealing over the past twenty years. It is contended that respondents have consistently eschewed various forms of price competition and channelled their energies instead into promotional activites and brand diversification.[2] Whether this conduct gives rise to a conspiracy to monopolize can be addressed only if a conspiracy in fact was properly tried. [3]

In finding that a conspiracy theory was not part of the case, ALJ Berman looked to the language of the complaint and statements made by complaint counsel during the prehearing conference stage of the proceedings. In particular, he found the complaint ambiguous, since it didn't mention specifically that either an agreement or conspiracy was at issue. Rather, the complaint charged, *inter alia,* that respondents "individually and collectively, have obtained,

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[1] See P. Areeda & D. Turner, III *Antitrust Law,* Ch. 8E (1978); R. Posner, *Antitrust Law: An Economic Perspective,* 39–77 (1976).

[2] Complaint counsel's conspiracy case depends primarily upon a showing that respondents' roughly parallel behavior on several fronts—instituting price changes, stopping trade deals, eliminating in-pack premiums, refusing to sell to private labelers, fortification—over a twenty year period cannot be explained away as a coincidence of independent judgments. While it is unnecessary to delve into this issue at any great length, since the conspiracy theory, as discussed hereinafter, is not properly before us, I would observe that this kind of evidentiary approach to proving collusion is not unprecedented. Cases such as *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946) and *Wall Products Co.* v. *National Gypsum Co.,* 326 F. Supp. 295 (N.D. Cal. 1971), indicate quite clearly that conspiracy can be inferred from proof of parallel actions coupled with economic conditions that appear to negate an inference of innocent, independent business conduct. This point is not to suggest that the case before us unquestionably involves a conspiracy, for, among other things, the evidence of simultaneity of behavior, (e.g., price leadership) here is perhaps not as strong as it was in the aforementioned cases. What it does suggest is that a conspiracy theory is not impotent to deal with oligopolistic behavior that exhibits more than a casual trend toward interdependent conduct.

shared and exercised . . . monopoly power in, and have monopolized, the production and sale of RTE cereal . . ." (Complaint, ¶9B). More importantly, ALJ Berman noted that complaint counsel had emphatically denied on several occasions early in the proceedings that the complaint contained a conspiracy count. (I.D. at pp. 3–10) Thus, although the first ALJ (Judge Hinkes) subsequently allowed the case to be tried on a tacit conspiracy theory, ALJ Berman found that procedure deficient since the complaint was not amended by the Commission and respondents did not acquiesce to that procedure. (See Rules of Practice Section 3.15) [4]

A review of the record indicates that, at best, the conspiracy pleading issue is murky. Obviously, we should not engage in excessive nitpicking of pleadings or overly technical interpretations, but the pleadings are not a model of clarity, especially in light of the shared monopoly theory being alleged. Words such as "combination" and "collectively" are used in the complaint, but those words are also consistent with a shared monopoly theory that requires no showing of collusion. Nevertheless, the pleadings might have been adequate to encompass a conspiracy to monopolize theory had it not been for complaint counsel's insistent denials that a conspiracy was at issue in the case.

During the prehearing conferences in 1972, ALJ Hinkes on more than one occasion sought further clarificaton of the pleadings from complaint counsel in view of their simultaneous denial of conspiracy and assertion that the case focused on joint, interdependent conduct. (Tr. 17, 25, 71, 104) After several tries, complaint counsel finally indicated that the case could encompass a tacit agreement (Tr. 106–08, 163–64), but only after having previously indicated that no traditional conspiracy was being alleged.[3]

Of course, as ALJ Berman noted, traditional conspiracies, under either Section 1 or Section 2 of the Sherman Act involve both express and tacit agreements. Thus, it seems hard to conclude that the case, as originally envisioned, encompassed a traditional Sherman Act-type conspiracy. Yet, that is precisely what complaint counsel now contend has been established in this case—a traditional Section 2, Sherman Act conspiracy to monopolize. (Complaint Counsel's Proposed Conclusions of Law, Vol. IV at 655–90, Sept. 30, 1980) Even giving the benefit of the doubt to complaint counsel, it is hard to understand why it was necessary to dance step around the conspiracy issue if the case clearly covered it. After all, the major case now

[3] Although the pleading issue was not before the court, it is interesting to note that the D.C. Circuit Court of Appeals, in a subpoena enforcement action brought four years after the case was filed, observed that a conspiracy was not alleged in the complaint. *FTC* v. *Lonning*, 539 F. 2d 202, 204, n. 3 (D.C. Cir. 1976).

relied upon by complaint counsel, *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946), which was decided twenty-five years before this case was brought, involved an implied conspiracy to monopolize. While there have not been many implied conspiracy cases brought under Section 2, there certainly have been numerous such cases under Section 1, and complaint counsel, in fact, cite to such precedent in support of their case. **[5]**

Perhaps, in denying that a conspiracy was at issue in the case, complaint counsel may have been attempting to distinguish between Section 1-type conspiracies and Section 2 conspiracies. There is, however, no evidence of that and, in any event, such a distinction would appear to be unnecessary since the type of proof needed to establish a conspiracy would appear to be much the same regardless of which provision of the Sherman Act was being pleaded. *See* P. Areeda & D. Turner, *supra,* note 1, ¶839. Alternatively, complaint counsel may have felt that the kind of tacit conspiracy they had in mind would not rise to the Sherman Act level, but if that is the case then the issue is little different from the pure Section 5 shared monopoly theory discussed below. There can hardly be two kinds of conspiracies, one sufficient to establish Sherman Act liability and another sufficient for Section 5 purposes.

To be sure, there have been suggestions that the scope of the conspiracy theory under the Sherman Act could be broadened to give greater emphasis to the use of economic evidence in determining whether a tacit conspiracy exists. *See* R. Posner, *supra,* note 1, at 71–77. Still, the issue is whether a conspiracy exists, not whether some other theory, by a different name, is viable.

Although ALJ Hinkes ultimately allowed the conspiracy charge to be tried, it is clear that the parties did not agree on this procedure and that no amendment to the complaint was sought from the Commission. Accordingly, I do not believe the Commission can hinge liability on a conspiracy theory.

Section 5 Shared Monopoly

Even if a conspiracy count is not present, that does not end the matter. Complaint counsel alternatively argue that even absent a conspiracy the conduct is sufficiently like one to justify a finding of liability under Section 5 of the FTC Act. It is quite clear, of course, that Section 5 can reach anticompetitive behavior that is not covered by the Clayton or Sherman Acts. And, I believe such authority

extends to non-collusive, marketwide behavior that may not involve traditional forms of predation.[4] Presumably, this could include behavior that would not be illegal for a single firm to engage in but, due to the industrywide nature of the practice, could lead to significant anticompetitive effects. [6]

Various commentators have also urged that the antitrust laws are flexible enough to deal with shared monopolies or oligopolistic behavior outside the context of a traditional conspiracy.[5] In highly concentrated industries competitors may learn to react to each others' moves in a fashion that is closely analogous to the workings of a cartel. Firms will recognize that it is not in their self-interest to chart an independent course because other competitors will be able to quickly detect and match their moves, thereby leading to lower profits for the industry as a whole. The degree to which this phenomena occurs, and its success, are obviously subjects of great debate and the identification of markets in which firms are operating in a closely interdependent fashion is admittedly complex.

Because of the difficulties in proving collusion, Professors Areeda and Turner have advocated a different approach to the problem of single firm monopolization and shared monopolies. In their recent treatise, they suggest that evidence of persistent monopoly performance in a market, whether exhibited by a single firm or a small group of firms, should be sufficient to justify sweeping relief in the form of divestiture or other like remedies. Of course, they would require fairly strong evidence that the market is performing badly and that structural remedies would not lead to inefficiencies. They also believe that such actions should be limited to government initiatives and not allowed in private suits. In essence, their proposal does not depend on improper conduct for establishing liability and is akin to various no-fault monopoly proposals that have been advanced in the past.

But even Areeda and Turner recognize that the kinds of markets that might warrant intervention under such an approach are limited, even more so in the shared monopoly area than for single firm monopolies.[6]

Complaint counsel, of course, are not advocating a no-fault approach in this case. Instead, they have attempted to develop their case in a way that focuses on the extent to which respondents' interrelated behavior has exacerbated competitive problems in the RTE cereal industry. Their theory depends less on the unreasona-

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[4] See, e.g., *Boise Cascade Corp., et al.*, 91 F.T.C. 1 (1978), *rev'd on other grounds, Boise Cascade Corp.* v. *FTC*, 637 F.2d 573 (9th Cir. 1980).

[5] *E.g.*, P. Areeda & D. Turner, *supra*, note 1; L. Sullivan, *Handbook of the Law of Antitrust*, Section 125 (1977).

[6] See P. Areeda & D. Turner, *supra*, note 1, ¶845.

bleness of specific forms of behavior than it does on the totality of the conduct. [7]

Nevertheless, even under complaint counsel's theory, one must recognize the implications of using such an approach to restructure an entire industry. As complaint counsel acknowledge, the kind of theory and relief they are seeking require extensive proof of industry structure, performance and conduct. While that kind of analysis is highly commendable, it provides a less than certain guide as to what kinds of conduct or market conditions would be subjected to antitrust attack. In addition, such an approach, of necessity, dramatically limits the number of instances where market intervention is warranted and, even then, it does not fully remove the risks associated with developing a structural remedy for an industry.

Thus, absent collusion or clear evidence of predatory behavior, I believe it would be unwise for the Commission to seek dissoultion of an industry on the basis of the cumulative effects of multi-firm behavior. That does not mean, however, that such behavior would go unaddressed. Rather, it means that the kind of relief sought—namely, conduct remedies—would reflect two realities about the oligopolistic market context: (1) the lower probability that serious anticompetitive problems will exist for long, and (2) the potentially greater costs of attempting to restructure an industry. Because of the complexity involved, it may take many years to recover the costs of obtaining and implementing a successful dissolution order. Those costs may be worth incurring where we can be fairly confident that the market behavior under attack cannot be justified. The rigor of conspiracy analysis can help to provide that assurance, and strong evidence of predatory behavior may also provide the necessary predicate for divestiture.

But to pursue structural relief in less compelling circumstances carries with it too great a risk of wrong or imperfect judgments. The alternative, conduct relief, obviously has its limitations. Such a focus, however, enables more precise judgments to be made about the reasonableness of particular behavior without the risk of overkill.[7] To [8]be sure, conduct relief may not be feasible in all oligopolistic market settings, but neither is divestiture. After all, antitrust deals primarily with probabilities. Where the probable benefits of improving competition are very high, as they are in breaking up a

[7] Apart from their suggested approach for dealing with persistent shared monopoly, Areeda and Turner also have expressed the view that the antitrust laws even more clearly can reach exclusionary behavior engaged in by shared monopolists. Such a theory would, they believe, amount to a logical extension of attempted monopolization, since the primary missing ingredient would be the absence of a dangerous probability of a single firm monopoly. P. Areeda & Turner, *supra*, note 1 ¶ 856–61. Whether the courts would be willing to extend Section 2 of the Sherman Act this far is not clear, but, in any event, such an approach would appear to be within the scope of ¶5 of the FTC Act.

horizontal price-fixing conspiracy, there is little risk that the imposition of harsh sanctions will chill desirable competitive behavior. But, as the difficulty of distinguishing between harmful and beneficial conduct increases, so does the danger of imposing maximum remedies. Therefore, in my view, remedial restraint is called for, even in the kind of tightly concentrated market presented to us here, where profitability is good, market shares are stable and new entry has been minimal.

Although I am opposed to structural remedies, I reiterate my belief that the Commission can reach non-collusive, industrywide behavior under Section 5 of the FTC Act. An example of such an approach is the Commission's decision in *Boise Cascade,* 91 F.T.C. 1 (1978), *rev'd, Boise Cascade Corp.* v. *FTC,* 637 F.2d 573 (9th Cir. 1980). There, the Commission found that the industrywide use of an artificial freight factor contributed to price stability and could not be justified by market exigencies. Although the Ninth Circuit Court of Appeals felt that the Commission did not make a satisfactory showing of anticompetitive effect, the appellate decision did not foreclose the possibility that the Commission could employ Section 5 to reach unjustified forms of non-collusive behavior which are practiced on a marketwide basis. It should also be emphasized that the Commission in *Boise Cascade* believed that it could fashion an effective conduct order that would not be highly regulatory in nature. If conduct relief can be easily evaded, or requires extensive government intrusion in ongoing market operations, there is little reason to press ahead. And, the absence of effective relief may suggest that there are offsetting competitive justifications for the practices under scrutiny.

As reflected in the *Boise Cascade* decision, the Commission may address multi-firm behavior that facilitates non-competitive conduct as well as more exclusionary forms of conduct. On the other hand, simply refusing to compete, by itself, probably would not be subject to attack—to do so would be analogous to going after a passive monopolist. However, passivity in an oligopolistic context is harder to maintain without resort to collusion or other practices that may contribute to a stable market.

In this instance, assuming complaint counsel's case were to be established, several practices might be singled out for [9]possible action. For example, a central issue in the case is brand proliferation. Complaint counsel argue that respondents have engaged in excessive product differentiation as a less disruptive form of competition than price competition. It is claimed that by carving up the market into smaller and smaller product segments, respondents

have made it extremely difficult for new firms to enter, since an entrant would have to offer several brands to achieve minimal scale economies. Moreover, a new firm could not expect established competitors to give much ground, as might be the case if limit pricing were being practiced, because of the difficulty of repositioning brands.

Without getting into an extended discussion of these allegations, there does seem to be considerable evidence that brand proliferation has made entry more difficult. But that is not the end of the analysis. Whatever the social value of these products, we are not dealing with the kind of product design or change that is introduced primarily as a blocking device to discipline competitors.[8] In other words, we are not talking about predatory conduct that serves little, if any, legitimate competitive ends. For the most part, the myriad cereal brands on the market are self-sustaining and they appear to generate significant consumer demand. Even if we would prefer to see fewer brands and more price competition, it would be extremely difficult to distinguish between legitimate and illegitimate brand proliferation. Certainly, it would be quite inadvisable and impractical to attempt to limit advertising expenditures or new brand offerings. Thus, an order provision directed to this practice does not seem very promising.

A second practice that might be susceptible to correction concerns respondents' shelf space recommendations to grocery retailers. These plans rely largely on past market shares as the benchmark for allocating space. Complaint counsel contend that these recommendations, which many retailers have adhered to in principle, tend to stabilize competition among existing competitors and make it more difficult for new entrants to get shelf space. Indeed, this is the only practice for which complaint counsel have sought conduct relief. **[10]**

It could be argued that an order restricting or preventing respondents from making shelf space recommendations would help to inject more competitive pressures into an important area of nonprice competition, without intruding unnecessarily into respondents' day-to-day business judgments. On the other hand, this type of activity is undoubtedly normal commercial behavior that is engaged in by many other food manufacturers, although it is not clear whether the nature and pattern of recommendations in the cereal industry are followed in other markets.

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[8] Allegations of this nature have been made in several recent cases involving the communications and computer industries. *Northeastern Tel. Co.* v. *American Tel. & Tel. Co.*, 497 F. Supp. 230, 244 (D. Conn. 1980), *rev'd* 651 F.2d 76, 94–95 (2d Cir. 1981); *Berkey Photo, Inc.* v. *Eastman Kodak, Co.*, 603 F.2d 263, 285 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); *Cal. Computer Products* v. *I.B.M. Corp.*, 613 F.2d 727, 744 (9th Cir. 1979); *Transamerica Computer Co., Inc.* v. *I.B.M. Corp.*, 481 F. Supp. 965, 1006–08 (N.D. Cal. 1979).

However, regardless of whether a workable remedy could be crafted on this subject, it is questionable whether the issue is all that important from a remedial standpoint. Dr. Schmalensee, one of complaint counsel's expert witnesses in the case, expressed the view in a separate article that shelf space plans were probably not powerful deterrant devices. Schmalensee, "Entry Deterrence in the Ready-to-Eat Breakfast Cereal Industry," 9 Bell J. Econ. 305, 307, n. 4 (1978).

A third area for possible relief involves the exchange of recent advertising expenditure data among respondents through the vehicle of a third party reporting service. It is not entirely clear whether this particular practice, specifically with respect to the accuracy and currency of the data exchanged, is unique to the cereal industry or occurs frequently in other industries. While this exchange makes it easier to monitor the actions of competitors it may be less sensitive than an exchange of price information, since the quantity of advertising expenditures does not necessarily reveal the effectiveness of those expenditures. Of course, the effectiveness of restricting this practice depends on how easily and quickly respondents could obtain similar data through other means. But, even if an order restriction would make that task substantially more difficult, it is not at all clear that it would inject a very significant destabilizing force into the market. To be sure, advertising is a major factor in respondents' non-price competition, but inducing more rivalry in this area is not necessarily calculated to produce similar spin-off effects in the pricing of RTE cereals.

Another candidate for reform is respondents' fairly consistent refusal to supply private brand cereals to retailers. While increased private brand competition could bring about more price competition, an order requiring respondents to supply such product is fraught with all kinds of problems, and could easily lead to a highly intrusive regulatory-type order. [11]

Finally, with respect to other allegedly anticompetitive conduct, such as respondents' refusal to offer trade deals or other off-list discounts, it is quite clear that the Commission cannot mandate respondents to compete. Such behavior, if it does not involve collusion, represents the kind of passive noncompetitive behavior noted above for which there is probably no practical enforcement remedy.

Thus, a review of possible avenues for conduct relief suggests that, assuming a Section 5 case can be made out, the available remedial alternatives are either intrinsically undesirable or hold little promise for producing beneficial results. To some extent, this task is made

more difficult by the fact that there is no record for determining which, if any, conduct restrictions would be useful, since the case from the outset focused almost exclusively on structural remedies. Nevertheless, despite this limitation, I am inclined to agree with complaint counsel that if any relief were suitable in this case, it should probably be structural in nature. However, for the reasons discussed previously, I am firmly opposed to seeking dissolution in a case of this kind without collusion, or possibly predation, as a legal predicate. While we might desire a better mix of price and non-price competition in the RTE cereal industry, the potential costs associated with a divestiture order, not to mention the difficulty in getting a court to approve such an exercise of our remedial discretion, lead me to reject this approach. I am also simply not persuaded that the class of cases reflected here is sufficiently large to warrant pursuing this kind of complicated, time-consuming remedial avenue. Even if this is the one case in a thousand that might justify such an approach, I do not feel that we ought to apply our Section 5 powers in this way, for what would be an essentially one-time, *ad hoc* law enforcement initiative.

Accordingly, it is my belief that the Commission should not pursue this case further.

DISSENTING STATEMENT OF COMMISSIONER PERTSCHUK

The Commission today takes an unprecedented step in refusing to hear the appeal of this matter. This decision raises serious implications for the integrity and propriety of Commission adjudicatory procedures. The complaint in this matter was issued in 1972 and it has taken nine years to complete pretrial procedures and the trial itself. The case raises difficult and unanswered legal questions as well as vigorously disputed factual controversies. Legal conclusions about the allegations in the complaint would have important ramifications for the applicability of the antitrust laws to concentrated industries which do not operate competitively. Thus, the case is precisely the kind of matter that warrants full-scale review by a responsible Commission, charged by Congress with adjudicatory determinations. I cite no less an authority than the Commission itself: "In this as in any other case, '. . . it is the agency's function, not the Examiner's, to make the findings of fact and select the ultimate decision, and where there is substantial evidence supporting each result it is the agency's choice that governs.'"[1]

[1] Order Denying Motion for Dismissal of Complaint Counsel's Appeal and for Adoption of Initial Decision, Docket No. 8883 (Nov. 3, 1981), citing *Greater Boston Television Corp.* v. *FCC*, 444 F.2d 841, 853 (D.C.Cir. 1970).

Yet the Commission has precipitously determined that it will not grant full-scale review of this matter, apparently on the grounds that it would be a waste of resources. The resources at stake apparently are the costs of a round of briefs concerning the administrative law judge's opinion, an oral argument, and the preparation of an opinion—not trivial, I grant, but not significant compared to the length, complexity and importance of this matter.

It cannot be ignored that this case has been controversial and that Congress has expressed concern about it. The respondents have attempted to make much of the fact that the Commission, at one point, offered a contract to the original trial judge to continue the matter after his intended retirement. In my view, this step by the Commission raised no significant question of impropriety, and the respondent's zeal in pursuing it has essentially been an aggressive legal and political maneuver. Respondents have also engaged in [2] intensive lobbying efforts in Congress to accomplish the premature demise of this case. I do not question their right to pursue either of these tactics. I do question, however, the propriety of Congressional intervention in any matter before it has run its course of proper adjudicatory procedures. I also question whether Congress has ever been furnished with a complete analysis of this difficult case and the legal arguments that have been raised in it.

I view the prior Congressional intervention in this matter, the vigorous efforts by respondents to heighten controversy about it, and the spurious characterizations of the Commission's effort to carry out its administrative responsibilities by offering a contract to the original trial judge as an unfortunate backdrop to this decision by the Commission to stop review of this matter in midstream.

This case was argued on the basis of two theories—1) a conspiracy based on traditional Sherman Act Section 1 principles and 2) a theory of interdependent behavior in a highly structured industry with poor competitive performance and where industry members have engaged in exclusionary conduct, what has come to be known in somewhat misleading shorthand as a "shared monopoly." If the case had been appealed, I would, of course, have carefully considered the conspiracy argument, which if proved, would certainly violate long-held principles of the antitrust laws. Based upon my tentative review, I am inclined to believe a finding of a traditional conspiracy could not fairly serve as a basis of liability.[2] I emphasize this conclusion is only tentative, and I would have wished to have heard further arguments by the parties on this issue.

[2] I base this conclusion on my interpretation of the complaint, which does not appear to allege a conspiracy, rather than the evidentiary record, which may well show a conspiracy existed.

As to the shared monopoly theory as initially pled, it is important to note what the theory is and what it is not. It is not an allegation of an agreement, either an expressed or implied conspiracy.[3] Consequently, it does [3]not fit the conventional analysis applied in Sherman Act Section 1-type matters. Nor is it an allegation of practices by individual companies which, under the circumstances of the industry, facilitate uniform pricing or other anticompetitive behavior. Finally, it is not an allegation that each firm engaged in exclusionary practices which independently violate Section 5 by unfairly raising barriers to new entry or driving out equally efficient competitors. Although there are aspects of these theories which were pled in the complaint, it is more appropriate to view the shared monopoly theory as standing apart from them and not requiring the same elements necessary to show a violation under these other theories. It is important to note, however, that these theories, which like the shared monopoly theory, are attempts to define illegal behavior in oligopolistic markets, are important to effective antitrust enforcement and are not undermined in any way by today's action by the Commission.

The shared monopoly theory, as reflected in the Commission's complaint in this matter, was predicated upon an allegation of high concentration, as evidenced by a three-firm concentration exceeding 80%; poor competitive performance, as measured, for example, by sustained high profits and the absence of price competition; and high barriers to entry caused by exclusionary conduct of industry members,[4] as evidenced, for example, by the absence of significant new entry since 1950. Thus, the theory of the case does not "condemn the [industry] structure itself" as the Bureau Director's statement of December 11 supposes.

Such a theory is supported by scholarly commentary, including that of Professors Areeda and Turner,[5] Professor [4]Sullivan[6] and others. Thus, it is not the case that "the theory has . . . utterly failed to enter the mainstream of economic thought," as the respondents claim. Rather, this case represents a serious, carefully thought out

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[3] A charge of conspiracy to monopolize could, of course, be based upon tacit collusion where joint action stems from assent by action rather than words. *Interstate Circuit* v. *U.S.*, 306 U.S. 208 (1939). Consequently, it would not have been unreasonable to plead a conspiracy based on the facts alleged in the complaint, though, as stated earlier, I do not believe the Commission did so.

[4] Exclusionary practices need not in themselves be independently unlawful or predatory to constitute acts of monopolization. *See, e.g, U.S.* v. *Griffith*, 334 U.S. 100, 105 (1948); *American Tobacco Co.* v. *U.S.*, 328 U.S. 781, 809, 814 (1946). Thus, each of the respondents need not have engaged in unfair predation under Section 5 or an attempt to monopolize under Section 2 of the Sherman Act in order to have been found to have engaged in monopolizing. We do not deal here with an allegation that there has been monopoly power shared by three firms without monopolizing conduct.

[5] *See* 3 P. Areeda and D. Turner, *Antitrust Law* 359–390 (1978).

[6] *See* L. Sullivan, *Antitrust* 361–366 (1977).

attempt by a no-nonsense Republican-led Commission in 1972 to deal with the problem of a tight oligopoly and a poorly performing industry.

Today, the Commission turns its back on this attempt, not wishing to deal with the difficult but necessary task of spelling out whether and under what circumstances the antitrust laws reach this problem. Such a step by the Commission is a significant one, with major ramifications for government antitrust policy. We should make no mistake about it: the problem of high concentration—industries operated by a few giant companies with poor competitive performance, as indicated by the absence of meaningful price competition and the absence of significant entry of new competitors over a long period—is not going to disappear from our economy in the coming decades. Our economy is now made up of a number of highly concentrated industries without meaningful price competition and, if the merger laws are not to be enforced vigorously, this situation will become more frequent, not less.

I for one believe that Section 5 of the Federal Trade Commission Act does reach a situation where an industry is highly concentrated; the performance of the industry as measured by profit levels, lack of price competition or other factors, is poor; effective barriers to entry are created by exclusionary conduct on the part of the firms; and a government-ordered remedy can be shown to be likely to improve competition. I also believe that it is possible for this Commission and for the courts to identify, after careful study, which industries are appropriate for restructuring in order to deal with the problem, and which industries are not.[7] But I also conclude that the prospect for some future Commission effectively to apply this theory is highly unlikely. It is not that there will not be farsighted and courageous Commissions in the future, nor certainly that there will be an absence of careful economic analysis capable of identifying **[5]** industries which should be addressed; nor do I view this decision by the Commission today in any way as a legal precedent which deserves to be followed by a future Commission or by the courts. Rather, I view today's decision as confirmation of the political inability of a Commission to see such a case through to the end.

As our political system provides, the Commission reflects, to a large extent, the prevailing political attitudes and the economic philosophy of the current administration. And, quite properly, future Commissions will reflect the then-prevailing political philosophy. Unfortunately, an attempt by the inherently lengthy process of

[7] In some situations, a conduct-oriented remedy alone may be adequate, *e.g.*, by prohibiting certain exclusionary practices.

litigation to deal with the oligopolistic problem I have described requires a political consensus that an independent commission is legitimate and competent to carry out the task, and a political environment which gives it the room and time to carry it out. Today's decision seems to me to tell us that such a consensus is unlikely. Therefore, I believe strongly that Congress, not this one perhaps, but some future one, should brace itself for the task of spelling out in careful, responsible legislation what government's role is in dealing with the problem of oligopoly. And I emphasize again that it is a problem which is destined to become more, rather than less, significant for our society.

STATEMENT OF COMMISSIONER PATRICIA P. BAILEY

This controversial case was formally launched on January 24, 1972, when Chairman Miles Kirkpatrick and Commissioners Rand Dixon and Mary Jones voted to issue the Commission's complaint.[1] Commissioners David Dennison and Everette MacIntyre opposed this action, and filed dissenting statements. Commissioner MacIntyre was prescient with regard to the ultimate procedural course of this matter, predicting "much litigation and little reform," and further suggesting that the resolution of certain "untried issues" could take "perhaps years". A Congressman from Michigan was prescient about the political course of this matter: the then-Representative from Battle Creek denounced the issuance of the complaint almost immediately.

The Commission's complaint (paragraph 9) charged three species of violations of the FTC Act: First, that the respondents had individually and collectively maintained a "highly concentrated, noncompetitive market structure." Second, that the respondents had individually and collectively shared and exercised monopoly power. Third, that the respondents "erected, maintained, and raised" barriers to entry of new competition through unfair methods of competition. The methods of competition in question representing the exercise of monopoly power, as detailed in paragraphs six and seven of the complaint, included: 1) brand proliferation through differentiating similar products and promoting trademarks through intensive advertising, 2) misleading advertising of the value of cereals in regard to childrens' health, weight control and athletic prowess, 3) control of shelf space, 4) acquisition of competitiors, 5) mutual restraint [2]in challenging price increases, 6) restricted use

[1] This was pursuant to the Commission's old Part II ("opportunity for settlement") Rules. The Part III adjudicative complaint issued in April 1972.

of trade deals or trade-directed promotion, and 7) limitations on the use of "consumer directed promotions, such as coupons, cents off deals, and premiums." According to paragraph 8, as a result of all this, high barriers to entry successfully forestalled new competition; the introduction of new products was curbed; cereal prices and profits were higher than they would be in a competitive market.

Much has been made, since the inception of this case, over the fact that it represents a test of the so-called "shared monopoly" theory. The complaint is subject to being so construed, depending on one's interpretation of paragraph 9(b).[2] It is certainly true that press reports and even academic journals have from the first characterized this case in terms of a shared monopoly theory.[3] The respondents in this matter have sought for years irrevocably to pin this badge on complaint counsel, who, for their part, have raced across the legal plain seeking to avoid the shared monopoly stigma, trying first the conspiracy gambit, falling at last across the finish line with a paper that mentions only "tacit collusion", and not shared monopoly even once. The Director of the Bureau of Competition believes that [3]only a shared monopoly theory was ever at issue in the case. The Administrative Law Judge details the history of the theory of the case, beginning with early pretrial statements by complaint counsel that conspiracy was specifically not a part of the complaint. Later, the original Law Judge assigned to this matter permitted complaint counsel—over strenous objections by respondents—to put into the record evidence of tacit collusion.[4] Judge Berman, though believing collusion not to have been pled as a part of this case, nonetheless based his ruling on consideration of *both* collusion *and* shared monopoly theories.

Judge Berman has dismissed this case for failure of proof on either of those theories.

The Director of the Bureau of Competition withdrew the earlier notice of intent to appeal filed in this matter because he believes a shared monopoly theory "is not consistent with the public interest," is "an unwarranted expansion of the law," and has the prospect of punishing success among the competing cereal producers. Withdrawal of an appeal of a Federal Trade Commission complaint by those

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[2] I objected, joined by Commissioner Pertschuk, to the singular characterization of this case as a shared monopoly matter in connection with the issuance of the press release dated December 18, 1981, announcing our 3–1 vote to solicit staff views on the propriety of the appeal of this matter. We felt that the characterization of the case was one of the main issues before us; but, in any event, the press release was issued notwithstanding our expressed concerns.

[3] "The Cereal Case: Opening Shots in FTC War on 'structual' Shared-Monopoly or Attack on 'marketing' irregularities?" 5 Antitrust Law and Econ.Rev. 71 (1971); "Oligopolies, Cereals, and Section Five of the Federal Trade Commission Act," 61 Geo.L.J. 1145 (1973).

[4] Orders of Judge Hinkes dated February 24, 1974, March 12, 1975, and August 20, 1976.

charged formally with its prosecution is virtually without precedent. The fact is that this is the Commission's—and not the staff's—complaint. The Bureau's involvement in this matter is in the nature of a stewardship, and the Bureau itself is but an administrative creation of the Commission to facilitate the accomplishment of tasks delegated to it by the Commission, including the litigation of Commission complaints. [4]

Nonetheless, the issue has been joined, and I do not fault the Director of the Bureau for candidly stating his views of which theories, in his opinion, the Commission should and should not be litigating.

My concern, expressed in our Order of December 18, 1981, following the Commission's receipt of the Bureau Director's views of December 11, 1981, was only that our Order of December 3, 1981, directing the submission of the views of complaint counsel be complied with. That has now belatedly been accomplished. As already noted, the attorneys and economist who have handled this matter for the past decade do not describe the case in terms of shared monopoly but in terms of tacit collusion, violative of the standards set out in *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946). "In the most traditional antitrust sense, the three respondents have tacitly colluded and cooperated to maintain and exercise monopoly power—'power over price' and 'power to exclude' additional competitors." According to the staff, "The case does not challenge the industry's structure itself," (Staff at 11), but shows a pattern of sophisticated conduct that has raised barriers to entry for new competition, and facilitated higher than competitive price levels.

I am aware of that body of commentary that believes the *American Tobacco* case adds to the law of monopolization by extending the analysis into an oligopoly setting. Professor W.H. Nicholls, stated as long ago as 1949:

> The *Tobacco* case is clearly a legal milestone in the social control of oligopoly. By permitting the inference of illegal conspiracy from detailed similarity of behavior . . . the [5]courts have at last brought oligopolistic industries within the reach of successful prosecution under the antitrust laws.[5]

He went on to say that the inference of conspiracy in the case was based on the assumption "that a few dominant firms will perhaps independently and purely as a matter of self interest, evolve non-aggressive patterns of behavior . . ." Professor A.D. Neale disagrees with this interpretation of the case. In response to Nicholls he stated:

[5] W. Nicholls, "The Tobacco Case of 1946," 39 American Economic Review, 296 (1949), cited as A.D. Neale, *The Antitrust Laws of The U.S.A.* 165 (2d Ed., 1970).

(H)e (Nicholls) is attributing to the court and the jury more economics than they would own: what the jury found and the Court confirmed was precisely that the conduct of the firms could not be accounted independent action. Rightly or wrongly, the Kentucky jury felt able to infer a true 'meeting of the minds' from the evidence, and the case really adds nothing new to the law of conspiracy. This is confirmed by Mr. Justice Burton's summary of this aspect of the case: 'The essential combination or conspiracy in violation of the Sherman Act may be found in a course of dealings or other circumstances as well as in any exchange of words . . . where the circumstances are such as to warrant a jury in finding that the conspirators had a unity of purpose or a common design and understanding, or a meeting of the minds in an unlawful agreement, the conclusion that a conspiracy is established is justified.'[6]

Despite complaint counsel's use of the terminology "tacit collusion," I believe such an argument amounts to allegation of a conspiracy, even under complaint counsel's cited cases. [6]

I am also constrained to agree with Judge Berman that a conspiracy charge was not a part of the Commission's complaint and that complaint counsel so stated in pretrial filings made on May 18 and 22 and June 19, 1972, and in pretrial statements made by complaint counsel Robert Liedquist on June 5 and 8 and August 10, 1972. The absence of a conspiracy charge was also asserted at least twice in federal court proceedings.[7] The admission of evidence on conspiracy made by the original ALJ, Judge Hinkes, amounted to a transgression of Commission Rule 3.15(a)(1) which prescribes the correct procedures for amendments to complaints. Nor does Rule 3.15(a)(2), providing for the admission of evidence "reasonably within the scope of the original complaint or notice of hearing," provide solace, since that rule requires both sides to acquiesce, and respondents have fought the notion of a collusion theory from the inception of these proceedings.

Viewing this case as a shared monopoly matter does not trouble me. Professors Areeda and Turner have postulated that

If . . . Sherman Act Section 2 permits a government action in equity against a substantial and persistent single firm monopoly that has not behaved improperly, it also permits a similar action against the substantial and persistent shared monopoly. As compared with single-firm monopoly, however, there are important additional difficulties in identifying cases suitable for intervention, identifying the proper defendants, formulating appropriate remedies, and supporting judicial innovation.[8]

The authors go on to state that evidence of shared monopoly power

[6] Neale, Op. Cit. 166. Violations of the Sherman Act are also violations of Section 5 of the FTC Act, *FTC* v. *Raladam Co.*, 283 U.S. 643 (1931).

[7] Contemporary reports of the Commission's action took special note of the absence of a conspiracy charge. Note, "Oligopolies, Cereals, and Section Five of the Federal Trade Commission Act," 61 Geo.L.J.1145, 1149 (1973).

[8] III Areeda and Turner, *Antitrust Law* 360 (1978).

should be coupled with evidence of "exclusionary conduct [7]having a significant causal relation to shared monopoly power."[9] For the purposes of my analysis, I am willing to assume that the exclusionary conduct alleged by complaint counsel has occurred, and that the respondents, three of which control 79% of cereal sales, share monopoly power in this $740 million market.[10]

The question then would be one of remedy. Indeed, the paramount difficulty with this case has always been the question of remedy. For whatever it is that Kellogg and the other respondents may have done, the proposed solution—to carve new cereal companies from the hides of existing ones and to force the licensing of successful trade names to the newly created competitors—is both draconian and manifestly uncertain to achieve the relief complaint counsel postulates that it will.

Areeda and Turner have stated:

> Quite apart from statutory limitations, even a czar would consider restructuring only where it is likely to improve net economic performance substantially; and we say 'substantially' to take account of the costs of the process, including the risk of erroneous judgments.[11]

Thus, assuming that the appropriate substantial and noncompetitive market structure required for a shared monopoly is present, the key issue becomes whether relief is available significantly to improve economic performance without sacrificing such economically worthy goals as substantial economies of scale.[12] [8]

The difficulties possibly attendant to divestiture relief make it less than clear that improved industry performance is the inevitable consequence. Respondents and intervenors (the grain millers union) view the industry restructuring proposal as "an unprecedented and unworkable experiment in industry reorganization" (Respondents at 5). Dismantling of existing cereal plants, including those that now make other non-cereal products as well, may cause substantial interruptions or reductions in production. Existing labor-management harmony may be disrupted. Trademark licensing may result in excess capacity and stifle product development, and disrupt economies of scale in production, distribution and sales. Of course, all of

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[9] *Id.*

[10] I recognize that the ALJ did not find this industry to be characterized by monopoly profits. I also recognize complaint counsel's strong assertion that the ALJ's methodology was faulty on this score.

[11] *Id.*, 372.

[12] For an interesting discussion of the primacy of economies of scale in oligopoly antitrust analysis, see Sherman and Tollison, "Public Policy Toward Oligopoly: Dissolution and Scale Economies," 4 Antitrust Law and Econ. Rev. 77 (1971). The evidence in this record on economies of scale is in conflict. Complaint counsel believe that entry into this market by a single cereal brand line is impractical, and that industry participation at from 3.5% to 5% is necessary to achieve firm economies of scale. This dispute bears both on the issue of barriers to entry as well as the issue of relief. Only an appeal of this matter would allow the Commission to assess the conflicting evidence.

this may be the conjecture of self-serving private interests, but the complex dismantling of a long-existing industry is sufficiently clouded with doubts to give one pause. Indeed, even complaint counsel's own expert has stated that the remedy proposed may "for reasons unforeseen bring about the opposite result or may impose debilitating losses upon the big three."

Moreover, it is also a concern of mine that an administrative agency, operating under a tightly supervised legislative mandate, undertake industry restructuring under a theory that clearly represents an extension of Sherman Act analysis. While Areeda and Turner believe that a viable shared monopoly theory exists, and that it can—even now—be entrusted to the government antitrust authorities, they acknowledge the difficulties of such a case. Concentration ratios and market performance tests, determination of markets appropriate for attack, and whether [9]there should be an assessment of substantial scale economies proved by an accused oligopolist, all present merely the threshold questions in approaching a shared monopoly prosecution.

Although not necessarily insuperable, these difficulties may suggest that the courts should refrain from taking so grave and novel a step without a new mandate from Congress. The issue is a serious one.[13]

I come ultimately to the view that industry restructuring, such as is proposed here, is essentially a legislative concern, and as an agency that fairly can be characterized as an arm of the Congress, we should not undertake to restructure an industry under Section 5 of the FTC Act without a clear supportive signal from the Congress. In this case, the signals are, for the present, quite to the contrary—as they were not so apparently in 1972 when this complaint issued. The Federal Trade Commission has from time to time commented favorably on various legislative proposals amounting to industrial restructuring.[14] None of these proposals has taken root as a preferred route for industrial market reorganization. I do believe that if the Congress were to endorse a shared monopoly approach to restructuring an oligopoly, this agency has the power to effect this sort of [10]change under a viable and respectable theory.[15] But the use of the power of divestiture or divorcement under Section 5 of the

[13] III Areeda and Turner, 380. Professor Turner's own views seem to favor the legislative approach; see: Turner, "The Scope of Antitrust and Other Economic Regulatory Policies," 82 Har. L. Rev. 1209 (1969).

[14] See for example: Statement of Federal Trade Commission before the National Commission for the Review of Antitrust Laws and Procedures, urging legislation affecting antitrust action against some monopolies, February 22, 1978.

[15] For a complete summary of the FTC view on this point, see: Testimony of Commissioner Robert Pitofsky on the Heflin Amendment before the Senate Commerce Committee, November 30, 1979. "Certainly the Commission has been restrained and circumspect in the extreme in imposing structural relief. We have been able to find only six cases since 1963 where structural relief was sought."

FTC Act is the ultimate exercise in administrative authority. It should be used only to achieve a Congressionally endorsed result, or at least not to defy a clearly expressed congressional animus, as exists here. I note, too, that even candidates of both major political parties in the last national election denounced this case as ill-advised and contrary to the public interest.

Why all this concern has risen to the level that it has is difficult to explain, in light of the fact that the Commission is only mid-stream in this case, and both Commission and court review—not to mention potential congressional action—lie ahead to safeguard against any precipitous or unwarranted action in this matter. The issue here is larger than the *Kellogg* case, to be sure. Professor Joseph Brodley reflected in some depth on the practical, as well as the philosophical, problem of exercising prosecutorial discretion to its ultimate end in cases of this sort:

> In law, as in politics, public policy must often be the art of the possible. For this, as well as for other reasons, I put to one side the proposal that existing concentrated oligopoly firms be broken up . . . (A)ny large or even moderate scale attack on existing industrial concentration would run into congressional stormwaters of imposing magnitude. [11]
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> In part, this may simply reflect an ambivalence of attitude in United States antitrust laws. The British writer, Neale, has noted the tendency of Americans "to take a romatic view of the achievements and efficiency of large industrial organizations even while they take a suspicious view of their power." (citation omitted) Such an attitude has made the remedy of divestiture rare even in Sherman Act cases.
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> Perhaps, more basically, in a nation so thoroughly pragmatic as this one, there is an understandable reluctance to push an economic theory, however well founded, to the extreme conclusion of causing drastic rearrangements of large sections of American industry. . . .[16]

The paradox we are left with is that while there may be a legitimate concern about the anticompetitive effects of the exercise of oligopoly power, it is rarely true that these concerns will mandate an administrative agency decision to restructure an industry, short of a legislative warrant to that effect. Therefore, I will vote that this appeal be terminated, not for the reasons relied upon by the Administrative Law Judge, but because the promulgation of relief by this agency will not, in any eventuality, conceivably lead to a restructuring of the cereal firms.

As may be evident, I do not intend the Initial Decision in this matter to become the final decision of the Commission. The Commission's Rules provide that if an appeal of an Initial Decision is

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[16] Brodley, "Oligopoly Power Under the Sherman and Clayton Acts - From Oligopoly Theory to Legal Policy," 19 Stan. L. Rev. 285, 344–45 (1967).

not forthcoming, the Initial Decision becomes the decision of the Commission.[17] According to complaint counsel, [12]the Initial Decision is riddled throughout with major procedural errors, and does not fairly give weight to certain of the evidence. I do not know whether this is true or not, and since I could not resolve these conflicts except through the process of appeal, it is my intention that the Initial Decision have no precedential or even persuasive authority for any proposition whatsoever. Thus, I will vote to docket the Initial Decision for the sole purpose of vacating it in its entirety and substituting for it a simple order of dismissal.

A few final words:

The fortitude and determination of those attorneys and economists who were charged so long ago by the Commission to prosecute this matter is a source of pride and admiration. No more difficult matter ever was considered to this point by this institution. No matter has been subjected to more criticism. No more difficult duty has been undertaken without sufficient thanks or recompense. In the face of everything, the staff of this agency has done the job it was ordered to do, and acquitted itself ably and with honor. The fact that now the Commission abdicates its commitment to see this matter through is a responsibility that rests uniquely upon our shoulders and not upon theirs.

I very specifically dissassociate myself from what the Chairman had to say about this matter in his statement of December 18, 1981. Neither do I join in Commissioner Clanton's statement of views on this matter nor in Commissioner Pertschuk's [13]clarion, but quixotic, call to battle.[18] I speak, only for myself, and I willingly take public and lasting responsibility for what I do today.

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[17] Rule 3.51(a).

[18] Commissioner Pertschuk's participation in this matter has been challenged; any legal ability to advance the appeal of this matter pursuant to Reorganization Plan No. 4 of 1961 would surely be challenged—adding only and inevitably to the record of delay of this case, diverting for additional years the Commission's ability to evaluate this case on the merits.

In the Matter of

RENUZIT HOME PRODUCTS COMPANY

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3081. Complaint, Jan. 20, 1982—Decision, Jan. 20, 1982

This consent order requires, among other things, a Philadelphia, Pa. manufacturer and distributor of transmission and hydraulic fluids and motor oils to cease making any representations concerning the API Service Classification, SAE Viscosity or any performance or quality characteristic of its motor oils unless the company possesses documentation supporting those representations. Respondent is further prohibited from misrepresenting the purpose, content, or conclusions of any test or survey, and required to furnish all personnel engaged in advertising, quality control or policy-making with a copy of the order.

Appearances

For the Commission: *Michael Dershowitz* and *Lewis Morris.*

For the respondent: *Pro se.*

Complaint

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Renuzit Home Products Co., a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

Paragraph 1. Respondent Renuzit Home Products Co. is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania, with its office and principal place of business located at 3rd and Berks Streets, Philadelphia, Pennsylvania.

Par. 2. Respondent is now, and for some time last past has been, engaged in the manufacturing, offering for sale, sale and distribution of motor oils, transmission fluids, and hydraulic fluids to retailers for sale to the public.

Par. 3. In the course and conduct of its business, respondent ships its products to wholesale purchasers throughout the Mid-Atlantic region. Respondent prepares promotional and labeling

materials for its product in Philadelphia, Pennsylvania and disseminates these materials throughout the Mid-Atlantic region. Respondent, therefore, maintains a substantial course of business, including the acts and practices as hereinafter set forth, which are in or affect commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. In the course and conduct of its business, and in order to induce the sale of its products to the public, respondent has disseminated labels for use on its motor oils.

Typical and illustrative of the statements and representations included on its labels, but not all-inclusive thereof, are the following:

API Services SE–CC–MS Meets API Specifications as shown on lid.

* * * * * * *

SAE 10W–20W–30

PAR. 5. At the time respondent made the statements and representations alleged above, it did not possess and rely upon a reasonable basis for such statements and representations. Therefore, said statements and representations were unfair, deceptive, or misleading.

PAR. 6. By and through the use of the aforementioned statements and representations, respondent has represented directly or by implication, that it had a reasonable basis for making, at the time they were made, the statements and representations alleged in Paragraph Four. In truth and in fact, respondent had no reasonable basis for such statements and representations. Therefore, said statements and representations were deceptive, misleading, or unfair.

PAR. 7. In the course and conduct of its business, and at all times mentioned herein, respondent as been, and now is, in substantial competition in or affecting commerce with corporations, firms and individuals engaged in the wholesale sale of motor oils, transmission fluids, and hydraulic fluids.

PAR. 8. The use by respondent of the aforesaid deceptive, misleading, or unfair statements and representations and their dissemination has had the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were true and complete, and into the purchase of substantial quantities of respondent's motor oils by reason of said erroneous and mistaken belief.

PAR. 9. The acts and practices of respondent, as herein alleged, including the dissemination of deceptive, misleading, or unfair

statements and representations, were all to the prejudice and injury of the public and of respondent's competitors and constituted, and constitute, unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act.

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act and;

The respondent and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent had violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Renuzit Home Products Co. is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania, with its office and principal place of business located at 3rd and Berks Streets, in the City of Philadelphia, State of Pennsylvania.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

PART I

It is ordered, That respondent Renuzit Home Products Co., a corporation, its successors and assigns, and its officers, and respondent's agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of motor oils in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

a. representing, directly or by implication, that its motor oils are of any American Petroleum Institute (API) Service Classification; or

b. representing, directly or by implication, that its motor oils are of any Society of Automotive Engineers (SAE) Viscosity; or

c. representing, directly or by implication, any other performance or quality characteristics of its motor oils;

unless each representation is true, and unless at the time of making each such representation, respondent possesses and relies upon competent and reliable scientific tests which substantiate each such representation.

For purposes of substantiating representations of the API Service Classification of any motor oil, respondent shall obtain for each such product passing scores on the appropriate engine sequence tests, as described in the then current SAE Technical Report J183, "Engine Oil Performance and Engine Service Classification", or any succeeding document which has the same force and effect as SAE Technical Report J183. In lieu of conducting engine sequence tests on motor oils of its own formulation, respondent may use a motor oil blend formula developed by another manufacturer, if a motor oil blended to that formula has been tested in a competent and reliable manner by the manufacturer that developed the motor oil blend formula or some other reliable testing facility in the manner set out above and has received passing scores, and respondent possesses true and complete documentation to that effect at the time it makes any representation of the API Service Classification of its own product. The initial testing to determine the API Service Classification of a motor oil manufactured according to any formula used by respondent shall be supplemented by respondent through periodic testing of batches, runs or blending tank lots of its motor oils. The samples to be tested shall be selected according to a predetermined protocol

consistent with proper quality control and shall be subjected to tests which indicate the presence and quantity of additives necessary to produce motor oil which conforms to the API Service Classification claimed for respondent's product. Respondent may choose any valid scientific method for the supplemental tests and the sampling protocols as long as the methods and protocols have been approved by the Commission staff.

For purposes of substantiating SAE Viscosity, each motor oil manufactured by respondent shall be tested in accordance with the procedures set out in the then current SAE Technical Report J300d, "Engine Oil Viscosity Classification" or any succeeding document which has the same force and effect as SAE Technical Report J300d, and must receive test scores within the limits described therein.

Each separate batch, run or blending tank lot of motor oil manufactured by respondent shall be tested for SAE Viscosity according to a predetermined protocol consistent with proper quality control and passing scores obtained before respondent makes any representations of the SAE Viscosity of its motor oil products. The sampling protocol to be used must first be approved by the Commission staff.

Attached to this Order and incorporated by reference is a protocol for the supplemental sampling and testing of respondent's motor oils. This protocol has been approved by Commission staff for use by respondent.

PART II

It is further ordered, That respondent Renuzit Home Products Co., a corporation, its successors and assigns, and its officers, and respondent's agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of motor oils in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from misrepresenting in any manner the purpose, content, or conclusions of any test or survey pertaining to motor oils.

PART III

It is further ordered, That respondent Renuzit Home Products Co., a corporation, its successors and assigns, and its officers, and respondent's agents, representatives and employees, directly or through any corporation, subsidiary, division or other device in connection with the manufacture, advertising, offering for sale, sale,

or distribution of motor oils in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from failing to maintain accurately, documentation that substantiates any and all of respondent's statements or representations on labels or other promotional materials disseminated by respondent or by any officer, representative, agent, employee, subsidiary or division of the respondent, concerning the API Service Classification, SAE Viscosity or any other performance or quality characteristic of motor oils. Such documentation shall be retained by respondent for a period of three years from the date such labels or other promotional materials were last disseminated, and copies thereof shall be furnished to the Commission staff upon reasonable notice.

PART IV

It is further ordered, That respondent distribute a copy of this order to each of its operating divisions, and to all present or future personnel, agents or representatives having advertising, quality control or corporate policy responsibilities with respect to the subject matter of this order and that respondent secure from each such person a signed statement acknowledging receipt of said order.

PART V

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change in the respondent, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this order.

PART VI

It is further ordered, That respondent shall, within sixty (60) days after service upon it of this order, and also one (1) year thereafter, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this order.

Renuzit Home Products Company Quality Control Protocol

[Date]

(Supersedes Any Previous Protocols)

I. DOCUMENTATION

A. The purposes for documenting the production of motor oil are to ensure product quality and to allow the identification of the cause of any variation from expected product quality.

B. All blending shall conform to the formulation set out in [name of additive package manufacturer] specification [identification name or number of specification] ([date of specification]). A motor oil blended to this specification received passing scores in engine sequence tests (SAE Technical Report J183) [test identification number] on [date of test score report] by [name and address of testing laboratory].

C. Each blend run shall be documented on a Blend Request Form. Each Blend Request Form shall contain the following information for each blend run:

1. blend run identification number;
2. blending tank number;
3. blending date;
4. time blending began;
5. time blending was completed;
6. total agitation time;
7. SAE grade;
8. API service classification;
9. blend stock storage tank identification number, and amount by volume of each base stock used in the blend run;
10. additive storage tank identification number or other container identification, and amount by volume of each additive package, viscosity index improver or other nonbase stock component of the blend;
11. total volume of final product;
12. blend formula identification name or number;
13. blend formulation by percent volume of each component used;
14. name of the person in charge of producing the blend run;
15. name of the person taking the blend run quality control sample;
16. name of the testing laboratory to which the blend run quality control sample is submitted; and
17. quality control manager's name, approval and date of approval.
18. identification number of the holding tank the blend run is transferred to; and
19. date of transfer to the holding tank, if different from the blending date.

D. All base stock, additives, viscosity index improvers and other components shall be recorded according to the date of delivery, invoice number, manufacturer and storage tank or other container.

E. All Blend Request Forms, component invoices, lists of blend component code numbers, blend formula specifications, Daily Gallonage Tankage Reports, Production Cards, Daily Production Record, Daily Laboratory Reports, and other documents relevant to a blend run shall be segregated and retained on file for three years after the date each blend run is produced.

II. BLEND SAMPLING

A. Upon completion of a blend run, the blending tank shall be sampled according to the then current ASTM Standard D 270–65 "Standard Method of Sampling Petroleum and Petroleum Products", or any succeeding document that has the same force and effect. The sample should be divided into equal portions.

B. Each blend run quality control sample portion shall be tagged and identified by blend run identification number, tank number, SAE grade, API service classification, and gallonage. Upon completion of identification, one sample portion shall be taken to the laboratory for testing. The other portion shall be retained and safeguarded for one year after the date the run is blended.

III. BLEND APPROVAL

A. Packaging of a blended product may *not* take place under any circumstances until the product has been approved by the Quality Control Manager after examination of the results of the laboratory tests on each blend run.

B. Approval of blended products shall be based on the results of the series of tests listed below. Reference is to the current version of these tests, or any succeeding document that has the same force and effect.

1. Multigrade oils:

a. Grades:
SAE 10w30 API Service Classification SF–CC
SAE 10w40 API Service Classification SF–CC
SAE 10w50 API Service Classification SF–CC
SAE 20w50 API Service Classification SF–CC

b. Tests Required:

Kinematic Viscosity @ 210°F	ASTM D445
Cold Cranking Simulator @ 0°F	ASTM D2602
API Gravity	ASTM D287
Color	ASTM D1500
Elemental analysis of: Barium, Calcium, Magnesuim, Phosphorus and Zinc (see Appendix A for analysis procedure)	

2. Single-grade oils:

a. Grades:
SAE 10 API Service Classification SF–CC
SAE 20 API Service Classification SF–CC
SAE 30 API Service Classification SF–CC
SAE 40 API Service Classification SF–CC

b. Tests Required:

Kinematic Viscosity @ 100°F	ASTM D445
Kinematic Viscosity @ 210°F	ASTM D445
Viscosity Index	ASTM D2770
API Gravity	ASTM D287
Color	ASTM D1500
Elemental analysis of: Barium, Calcium, Magnesium, Phosphorus and Zinc (see Appendix A for analysis procedure)	

C. The results of the testing listed above shall be recorded by laboratory personnel on the Blend Request Form and the Daily Laboratory Report.

D. Each Blend Request Form shall be reviewed by the Quality Control Manager for *final* approval. Approval shall be based on the comparison of the test results for the blend run quality control sample to the specifications concerning viscosity set out in SAE Technical Report J300d, "Engine Oil Viscosity Classification", or any succeeding document that has the same force and effect, and data concerning additive levels supplied by [name of additive package manufacturer]. (See [blend formula specifications]).

E. Once final approval is given by the Quality Control Manager, the product shall be entered on the Daily Gallonage Tankage Report, which shall identify each blend by SAE grade, API service classification, tank number, blend run identification number and date blended.

IV. PACKAGING OF APPROVED BLENDED PRODUCT

The Daily Gallonage Tankage Report shall be used as a guide by the Production Manager when assigning work to the filling lines. Instructions shall be issued via the Daily Production Record, which shall identify the tank from which oil of a particular viscosity grade and API service classification shall be drawn, the size of containers to be filled, the quantity to be filled, and the date coding to be used. All filled cases of motor oil containers shall be date coded as per the Production Card.

V. FILLING INSPECTION OF APPROVED PRODUCT

A. It is the Filling Line Foreman's responsibility to obtain a sample directly from the filling pipe line for each product being filled. A filling sample shall be obtained within the first five minutes of the filling production run, identified by SAE grade, size and type of container being filled and the identification number of the tank the product is being drawn from, and immediately taken to the laboratory. If a large filling production run of the same product is interrupted by a rest or lunch period, another filling sample shall be taken when a new start-up is made.

B. The tests required to be performed by the laboratory on a filling sample are the same as those required for blend run quality control samples under Paragraph III above, with the exception of elemental analysis. Filling shall stop immediately upon discovery of any deviation in the filling sample test results from the blend run quality control sample test results for the product being tested. Filling may resume only if upon the testing of additional filling samples, the product obtains test results conforming to the results from the testing of the blend run quality control sample. All cases filled prior to a stoppage shall be tagged defective and disposed of.

APPENDIX A

Elemental analysis is performed by: [name of laboratory] A Baird's atomic emission spectrometer or other appropriate equipment shall be used to determine the parts per million of the additive metals in the finished oils. The testing equipment test element shall be calibrated in accordance with the standards for [identification name or number of the blending formula] supplied by [name of additive manufacturer] via Renuzit.

Blend run quality control samples sent to [name of laboratory] for analysis shall be identified by the SAE grade of the product and by the blend run identification number preceded by the number representing the month of the year in which the oil is

produced. [Name of laboratory] shall verbally transmit to Renuzit the results of the elemental analysis on the day the analysis of the blend run quality control sample is performed, with written confirmation to be received by Renuzit within five working days after completion of the tests.

IN THE MATTER OF

AMERICAN HOME PRODUCTS CORPORATION, ET AL.

Docket 8918. Interlocutory Order, Jan. 21, 1982

ORDER DENYING PETITION FOR RECONSIDERATION

Respondent American Home Products Corporation ("AHP") has requested Commission reconsideration of its opinion and final order in this matter, pursuant to Rule 3.55 of the Commission's Rules of Practice. Rule 3.55 reads, in relevant part, that any request for reconsideration "must be confined to new questions raised by the decision or final order and upon which the petitioner had no opportunity to argue before the Commission."

Respondent argues that reconsideration should be granted because it was not given an opportunity to address the "substantial question" theory which it alleges was the basis for the substantiation and disclosure requirements in the final order. It notes that the Commission decided the so-called "substantial question" allegations of the complaint on deception grounds, and argues that it could not have anticipated such a result given that the Administrative Law Judge relied on a theory of unfairness in resolving these allegations against respondent. AHP also challenges the basis for the Commission's conclusion that consumers were deceived by AHP's failure to disclose the existence of a substantial question in the scientific-medical community. AHP argues that the conclusion rests on assumptions regarding consumer beliefs about the level of proof for its comparative superiority claims for Anacin that were not in issue below and are unsupported by the record of this proceeding. Finally, AHP argues that it is especially important for the Commission to consider anew its decision in this matter not only because of the allegedly "new" question of consumer beliefs, but because the composition of the Commission has changed since the opinion and final order were issued on September 9, 1981.

We believe that granting respondent's request for reconsideration would be inappropriate. The complaint made it clear that the alleged failure to disclose the existence of a substantial question about AHP's comparative superiority claims, if proven, was an unfair or deceptive practice in violation of Section 5 of the FTC Act. (Comp. ¶¶ 12–14, 25, 27). Thus, AHP was placed on notice from the very beginning that there was a "substantial question" issue which might be decided on the basis of a finding of deception. Further, as the record clearly demonstrates and as complaint counsel point out, Answer to Motion at 2–3, Respondent AHP has vigorously litigated

and argued the merits of the "substantial question" allegations of the complaint throughout this proceeding before the Commission. Respondent's assertion that it was denied notice and opportunity to address the "substantial question" theory as such is thus without merit. (See also C.Op. at 36–38).

In addition, AHP's charge that the differing legal theories of the Initial Decision and the Commission's Opinion on the "substantial question" issue constitute grounds for reconsideration—because it could not have anticipated that the Commission would depart from the approach taken by the ALJ—is also unfounded. The allegations of the complaint, and not the theory of the Initial Decision, set the bounds for decision by the Commission. In this case, as we have noted, the complaint alleged that AHP's failure to disclose the existence of a substantial question was deceptive or unfair. Contrary to what respondent's argument seems to imply, the mere fact that the ALJ's decision was based on an unfairness theory obviously could not have operated to erase the pleaded theory of deception from the case, or otherwise limit or foreclose the Commission's ability to decide the case on that ground. In any event, the distinction between the theories adopted by the Commission and the ALJ was not as dramatic as AHP implies. Both the ALJ and the Commission focused on the untrue implication in AHP's advertisements, absent disclosure of the existence of a substantial question, that it had a reasonable basis for the comparative claims made for its products. That the ALJ couched his conclusion in terms of unfairness rather than deception is, in the context of this case, a difference more of form than of substance.

We also reject respondent's contention that the question of consumer belief, which underlies its motion for reconsideration, was not an issue in the trial or could not have been anticipated by respondent to be an element of the Commission's decision. Again, we refer to the complaint. Paragraph 14 of the complaint alleged that in light of the comparative superiority claims allegedly made by AHP, "the existence of such a substantial question is a material fact, which, if known to consumers, would be likely to affect their consideration of whether or not to purchase such products." This count clearly implied an allegation that consumers may reasonably believe that unqualified comparative superiority claims signaled the absence of any substantial question about them in the scientific-medical community. From the outset, therefore, the nature of reasonable consumer beliefs about the level of support for these claims in the scientific-medical community was in issue.

Furthermore, the question of reasonable consumer beliefs re-

mained very much in issue throughout this litigation. Respondent had abundant opportunity both to challenge the legal argument that extrinsic evidence of consumer beliefs was not essential to a finding of deception under complaint counsel's "substantial question" theory, and to offer such evidence of its own to demonstrate that, contrary to the allegations of the complaint and the Commission's conclusion, consumers would not reasonably believe that AHP's comparative superiority claims were established beyond substantial question in the scientific-medical community.[1]

Finally, we believe respondent's view that the "new" Commission should have an opportunity to consider this case is improperly raised in the context of a motion for reconsideration under Rule 3.55, which speaks solely in terms of new questions and not new Commissions.

For lack of a majority, *it is ordered,* that respondent AHP's motion for reconsideration and accompanying application for oral argument on its motion,[2] filed October 30, 1981, are hereby denied.

Chairman Miller and Commissioner Clanton favor reconsideration. See their attached separate statements.

SEPARATE STATEMENT OF CHAIRMAN JAMES C. MILLER III

I agree with the views expressed by Commissioner Clanton in his separate statement. Given the posture of this case, I too think it would be wise for the Commission to stay, or reconsider, its order pending resolution of *Bristol-Myers Company,* No. 8917 and *Sterling Drug, Inc.,* No. 8919, the other two analgesic cases that are before the Commission. Such action would give the Commission the opportunity to modify its order in *AHP,* if necessary, and thereby ensure consistency with respect to the similar issues raised in all three cases.

SEPARATE STATEMENT OF COMMISSIONER DAVID A. CLANTON

Respondent argues that the Commission majority's treatment of

[1] The Commission's ruling was based on the capacity of the unqualified advertising claims in question to deceive reasonable consumers, and therefore rested upon evidence tending to show how the advertising could reasonably have been interpreted by consumers, as well as upon the evidence of actual deception that is in the record. *See* C.Op at 29–32. While the evidence of actual deception, or countervailing evidence suggesting that consumers, in fact, had not been misled might have been relevant, it was not dispositive of the issue.

[2] In this application, respondent argues for the first time in connection with its motion for reconsideration that the Commission may want to reconsider its opinion and order in this matter in order to consider and possibly avoid potential conflict between its decision in this case and two other pending analgesics cases, *Bristol-Meyers Co.,* Docket No. 8917 and *Sterling Drug, Inc.,* Docket No. 8919. The Commission was fully aware of the possible interrelationship between those cases and this one when it decided to issue its opinion and order in this matter. AHP's concern that after all these cases are decided it could be the only one of the three companies operating under the kind of order issued in this case rests at present on sheer speculation. Should the situation that APH fears be the end result of these proceedings, AHP may, of course, pursue whatever relief it believes is warranted through the reopening procedures of 16 C.F.R. 3.72.

the substantial question issue in its opinion of September 9, 1981, raises a new question warranting reconsideration under Rule 3.55. I dissented from the majority position on the substantial question issue, but I do not believe that respondent's motion satisfies the criteria for further briefing on the matter.

I do believe, however, that the Commission should preserve the option of reviewing the case at the time it resolves the appeals of the other analgesics proceedings (*Bristol-Myers Company,* No. 8917, and *Sterling Drug, Inc.,* No. 8919). The three analgesics cases, at least in part, raise similar issues. It is conceivable that the opinion and order in *American Home Products* will require some modification to ensure that the company and its competitors are treated equally.

Consequently, I think that, purely as an exercise of its discretion, the Commission should have either stayed the order against American Home Products or voted to reconsider the case pending resolution of the other analgesics appeals.

In the Matter of

AMERICAN HONDA MOTOR COMPANY, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3082. Complaint, Jan. 22, 1982—Decision, Jan. 22, 1982

This consent order requires, among other things, a Gardena, Calif. motor vehicle dealer to cease failing to mail to each owner of a Honda automobile which was purchased as new, or is currently registered in certain states, a "notice package" containing information regarding the company's redress program for premature fender rusting. The company must timely remove and replace, at no cost to the owner, the front fenders of any Honda automobile experiencing premature rusting within 36 months-in-service, and reimburse eligible owners of affected vehicles for monies spent in trying to correct the premature rusting problem. Respondent is also required to inform its dealers of the firm's obligations under the provisions of the order, and provide them with adequate supplies or reimbursements for replacing rusted fenders. Additionally, the order requires respondent to maintain documents demonstrating compliance with the order for a period of not less than three years.

Appearances

For the Commission: *Joel Winston* and *Jeffrey Karp.*

For the respondent: *Henry P. Sailer, Covington & Burling,* Washington, D.C., and *James J. Short, Lyon & Lyon,* Los Angeles, Calif.

Complaint

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that American Honda Motor Co., Inc., a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

Paragraph 1. Respondent American Honda Motor Co., Inc. is a California corporation, with its principal office and place of business at 100 West Alondra Boulevard, Gardena, California.

Par. 2. Respondent is now, and has been, engaged in the advertising, offering for sale, sale and distribution of Honda automobiles to members of the public.

Par. 3. In the course and conduct of its aforesaid business,

respondent causes and has caused automobiles to be shipped to purchasers in various States, and therefore maintains, and at all times mentioned herein has maintained, a substantial course of trade in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. For the purpose of this complaint, "premature fender rusting" shall mean hole(s), blister(s) or bubble(s) in the exterior paint or metal of the front fenders, which is caused by rusting of the metal and is not attributable to normal deterioration of the metal as a result of age.

PAR. 5. In the course and conduct of its aforesaid business, respondent offered for sale, sold and distributed 1975–1978 model year Honda automobiles which were subject, in a significant number of instances, to premature fender rusting.

PAR. 6. In the course and conduct of its business, respondent has failed to disclose facts concerning the existence, nature, extent, prevention or proper repair of premature fender rusting affecting certain Honda automobiles manufactured between the period from 1975 to 1978, notwithstanding that it knew or should have known of such facts.

PAR. 7. The facts referred to in Paragraph Six would have been material to many prospective purchasers, because, if known, they would have been likely to affect those persons' decisions concerning the purchase of such automobiles. Respondent has therefore failed to disclose material facts to prospective purchasers of Honda automobiles.

PAR. 8. The facts referred to in Paragraph Six are material to many owners, because, if known, they would be likely to affect those persons' decisions concerning the maintenance, repair, use or care of such automobiles. Respondent has therefore failed, and is failing, to disclose material facts to owners of Honda automobiles.

PAR. 9. Respondent's acts and practices in failing to disclose material facts, as alleged in Paragraphs Six through Eight above, have had, and now have, the capacity and tendency to mislead members of the public, including prospective purchasers and owners of Honda automobiles. Such acts and practices also cause and have caused substantial economic harm to members of the public, including prospective purchasers and owners of Honda automobiles, who make payments for goods or services which they might otherwise not make; or fail to take measures which they might otherwise take to prevent damage to their automobiles.

PAR. 10. Respondent's acts and practices, as alleged herein, were and are all to the prejudice and injury of the public and constituted,

and now constitute, unfair or deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act.

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comments filed thereafter by interested persons pursuant to Section 2.34 of its Rules, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent American Honda Motor Co., Inc. is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its office and principal place of business located at 100 West Alondra Boulevard, in the City of Gardena, State of California.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For the purposes of this Order, the following definitions shall apply:

1. *Honda automobile(s)* shall mean all 1975, 1976, 1977 and 1978 model year Civics and all 1976, 1977 and 1978 model year Accords sold or distributed by respondent in the United States.

2. *Premature rusting* shall mean the presence of hole(s), blister(s) or bubble(s) in the exterior paint or metal of the front fender, (a) which is caused by rusting of the metal from the underside of the fender, (b) any part of which is within two feet of the rear edge and one foot of the top edge of the fender, and (c) that appeared within the automobile's first thirty-six (36) months-in-service.

3. *Remove and replace* shall mean removal of the fender and replacement with a new fender which has been treated with a zinc coating process similar to Zincrometal with a nominal thickness of 0.5 mils or greater; *provided,* that if said new fender is not reasonably available due to circumstances beyond respondent's control, respondent may use a fender which has been one-side galvanized with a nominal weight of 60 grams per square meter (gm/m2) or greater and which has been primed using a cathodic electrodeposition process. This term shall also include all parts and labor necessary to (a) install and paint the replacement fender in as close to a matching color as possible, (b) re-affix all pre-existing trim and accessory items and replace any such items damaged during removal and replacement with identical items, if reasonably available, or similar items, if identical items are not reasonably available, (c) make all adjustments to the automobile necessitated by the removal and replacement of the fender, and (d) repair or replace, as is appropriate, any rusted structural or support component for the fender to the extent necessary to permit proper and sound installation of the fender.

4. *Dealers(s)* shall mean all persons, partnerships, firms or corporations which, pursuant to a Honda Automobile Dealer's sales and service agreement with respondent, receive on consignment or purchase new Honda automobiles from respondent for resale or lease to the public, including any person(s), partnerships(s), firm(s) or corporation(s) owned or operated by respondent.

5. *Owner(s)* shall mean any person, partnership, firm or corporation having custody and/or possession of a Honda automobile, including those automobiles held for resale. This term shall include, but not be limited to, any registered owner or lessee, or person acting on their behalf. This term shall not include insurers, warrantors or

automobile repair facilities which are not registered owners or lessees of the automobile, whether or not acting on behalf of an owner.

6. *Past or current owner(s)* shall mean any person, partnership, firm or corporation having custody and/or possession of a Honda automobile, or which had at any time in the past custody and/or possession of a Honda automobile, including those automobiles held for resale. This term shall include, but not be limited to, any registered owner or lessee, or person acting or who acted on their behalf. This term shall not include insurers, warrantors or automobile repair facilities which are not, and were not, registered owners or lessees of the automobile, whether or not acting on behalf of a past or current owner.

7. *Months-in-service* shall be calculated as beginning on the date on which respondent began warranty coverage on the automobile. If that date cannot be established by respondent, the months-in-service shall be calculated as beginning not earlier than:

1975	Civic 1200, Civic CVCC & Civic Wagon	November 26, 1975
1976	Civic 1200, Civic CVCC & Accord	December 6, 1976
	Civic Wagon	December 8, 1976
1977	Civic 1200	December 14, 1977
	Civic CVCC	December 20, 1977
	Civic Wagon & Accord	December 5, 1977
1978	Civic 1200	October 12, 1978
	Civic CVCC & Civic Wagon	October 26, 1978
	Accord	October 17, 1978

I

It is ordered, That respondent American Honda Motor Co., Inc., a corporation, its successors and assigns, and it officers, agents, representatives and employees, directly or indirectly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of any motor vehicle in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Failing to send by first-class mail, within sixty (60) days after the date of service of this Order, a notice package consisting of (i) a copy of the letter attached to this Order as Attachment A, incorporated herein by reference, (ii) a copy of the form attached to this Order as Attachment B, incorporated herein by reference, and (iii) a self-addressed, postage-paid envelope. Respondent shall com-

plete all insertions in Attachment A and the top portion of Attachment B for each such notice package. The notice package shall be sent in one envelope, similar in all material respects to Attachment C of this Order, incorporated herein by reference. The notice package shall be mailed to each current registered owner of a Honda automobile which was purchased as new, or is currently registered, in any of the following states. Such owners shall be determined by current state motor vehicle records of a commercial locator service and by respondent's warranty registration records.

Connecticut	Missouri
Delaware	Nebraska
District of Columbia	New Hampshire
Illinois	New Jersey
Indiana	New York
Iowa	Ohio
Kansas	Pennsylvania
Kentucky	Rhode Island
Maine	Vermont
Maryland	Virginia
Massachusetts	West Virginia
Michigan	Wisconsin
Minnesota	

Respondent shall also send or cause to be sent a notice package, with all insertions provided for in Attachment A and the top portion of Attachment B completed, to the extent that information provided by the inquiring past or current owner permits, within thirty (30) days of the inquiry, or sixty (60) days after the date of service of this Order, whichever date is later, to each past or current owner of a Honda automobile who inquires before July 1, 1982* to respondent or a dealer about respondent's redress program for premature fender rusting, and who:

i. Was sent a notice package but has not received it by the seventieth (70th) day after the date of service of this Order;

ii. Was not sent, and is not scheduled to be sent, a notice package; or

iii. Received a notice package but subsequently lost it.

B. Failing to remove and replace, at no cost to the owner, within 180 days after the owner presents the automobile to a dealer for an inspection with his or her pre-printed Attachment B form, the front

* Modified by direction of the Commission dated March 4, 1982.

fender(s) of any Honda automobile experiencing premature rusting. Said inspections shall be available at all times during the dealer's normal service hours and shall be performed within a reasonable period of time. At the inspection, respondent shall cause to be returned to each owner three copies of Attachment B with all appropriate insertions completed. Except as otherwise provided by this Order, no owner shall be required to submit an automobile for any purpose or at any time, to a dealer or respondent, in order to receive any benefits under this Order, other than on one occasion for an inspection, and one occasion, at a time mutually agreed upon between the owner and the dealer, for removal and replacement. Each removal and replacement shall be completed within a reasonable period of time after the owner presents the automobile to a dealer for the removal and replacement at a time mutually agreed upon between the owner and the dealer.

Provided further, That in each instance where a dealer rejects a request for removal and replacement, respondent shall cause to be provided to each such owner a written report, completed and signed by the dealer, describing in detail the reasons why the request was rejected and containing instructions on how the owner can seek a review of the rejection by respondent. In each case where the rejection is based upon a determination that the front fender(s) are not experiencing premature rusting, as defined by this Order, said written report shall describe in detail the condition of the fender(s) and all tests performed to determine the cause or source of any rusting. Respondent shall review each rejected request within a reasonable time after an owner requests a review from respondent's zone office. In each case where the rejection was based solely upon the dealer's determination that the hole(s), blister(s) or bubble(s) in the exterior paint or metal of the fender were not caused by rusting of the metal from the underside, and unless said rejection is reversed, said review shall include, if requested by the owner, an inspection of the fender(s) by an employee of respondent. Respondent shall provide to each such owner a second written report describing in detail the findings of this inspection.

Provided further, That in each instance where the fender(s) on a Honda automobile have not been replaced within 180 days after the owner presented the automobile with the pre-printed Attachment B form to a dealer for an inspection, respondent shall offer the owner the option of receiving either a cash settlement of $150 per rusted fender, or replacement of the fender within a reasonable period of time set by the dealer. Within sixty (60) days after respondent receives from the owner a completed and signed copy of Attachment

B requesting the cash settlement, respondent shall mail to each such owner a check for $150 for each front fender experiencing premature rusting. Respondent's obligation under this proviso to offer the cash settlement shall not extend to any owner who fails to present his or her Honda automobile for removal and replacement, within said 180 day period, at the time(s) mutually agreed upon between the owner and the dealer or reasonably scheduled by the dealer if the owner will not agree to a reasonable time.

Provided further, That respondent may require any owner whose automobile exceeds thirty-six (36) months-in-service to sign the statement, contained in Attachment B, certifying that the automobile experienced premature rusting, and that the individual was an owner of the automobile, within its first thirty-six (36) months-in-service and is currently an owner.

Provided further, That respondent shall not offer any form of compensation for premature rusting to any such owner other than the compensation specifically provided for by this Order.

C. Failing to reimburse any past or current owner of a Honda automobile for all expenses incurred for repairs or replacements which were intended to eliminate premature rusting, whether or not they eliminated the premature rusting. Such reimbursement shall consist of all monies expended by the past or current owner, if the services were performed by a dealer or subcontractor of the dealer; or all monies expended by the past or current owner, or the usual and customary charges in the past or current owner's trade area for the work performed, whichever is lower, if the services were performed by a person, partnership, firm or corporation other than a dealer or subcontractor of the dealer.

Such reimbursement shall be made within sixty (60) days after respondent receives from the past or current owner (i) a completed and signed copy of Attachment B, certifying that the automobile experienced premature rusting, and that the individual was a past or current owner of the automobile, within its first thirty-six (36) months-in-service, and (ii) reasonable evidence of repair or replacement expenses.

Provided, That respondent's obligations under this Paragraph shall apply only if such repairs or replacements were made prior to the past or current owner's receipt of a notice package from respondent as provided for by Paragraph A of Section I of this Order.

Provided further, That respondent may require any owner to submit his or her Honda automobile to a dealer for an inspection as a condition of reimbursement under this Paragraph.

D. Failing to provide all dealers with adequate supplies of, or in

the alternative to reimburse all dealers to the extent of respondent's normal warranty reimbursement policy and procedures for obtaining, new front fenders and all other items necessary to effectuate the reasonably forseeable removal and replacement of the fenders.

E. Failing to provide all dealers with adequate supplies of Attachment B, with pre-printed portions blank.

F. Failing to notify all dealers in writing within ten (10) days after the date of service of this Order of the existence of premature rusting, of the terms and conditions of respondent's obligations under this Order, and of the necessity for dealers to avoid any practices which might hinder, delay, restrict or frustrate the proper administration of this Order.

II

It is further ordered, That respondent's obligations under this Order shall not extend to the following:

A. Under Paragraph B of Section I of this Order, (i) to those owners who initially present their automobile to a dealer for an inspection after their automobiles have reached forty-two (42) months-in-service, or after six (6) months after the date of service of this Order, whichever date is later; (ii) to those owners who fail, before May 1, 1983, to present their automobiles for removal and replacement at a time mutually agreed upon between the owner and a dealer, or to mail to respondent a completed and signed copy of Attachment B requesting a cash settlement; or (iii) to more than one owner for each Honda automobile.

B. Under Paragraph C of Section I of this Order, to those past or current owners who mail Attachment B to respondent after their automobiles have reached forty-two (42) months-in-service, or after six (6) months after the date of service of this Order, whichever date is later.

III

It is further ordered, That respondent shall provide to each dealer, within thirty (30) days after date of service of this Order, a display poster, no smaller than 30 inches by 40 inches, in the form of Attachment D to this Order, incorporated herein by reference. Respondent shall advise dealers to place the poster in a conspicuous and accessible location in the service writer's area of the dealership, and to keep the poster posted until July 15, 1982.

IV

It is further ordered, That respondent maintain documents demonstrating compliance with this Order for a period not less than three (3) years. Such documents shall be made available to the Commission or its staff for inspection and copying upon reasonable request, and shall include, but are not necessarily limited to, those revealing:

A. The name and last known address of each owner who was sent the notice package required by Paragraph A of Section I of this Order.

B. The name and last known address of each owner whose notice package was returned by the U.S. Postal Service undelivered.

C. The name and last known address of each owner who requested removal and replacement.

D. The name and last known address of each owner whose fender(s) were removed and replaced, pursuant to Paragraph B of Section I of this Order, within 180 days after the owner presented the automobile to a dealer for an inspection with his or her Attachment B form.

E. The name and last known address of each owner whose fender(s) were removed and replaced more than 180 days after the owner presented the automobile to a dealer for an inspection with his or her Attachment B form, and the number of days in excess of 180 that the fender(s) of each such owner were replaced.

F. The name and last known address of each owner who received a cash settlement due to a dealer's inability to remove and replace the fender(s) within said 180 day period.

G. The name and last known address of each past or current owner who requested reimbursement for prior repairs or replacement of front fender(s) with premature rusting.

H. The name and last known address of each past or current owner who was reimbursed for prior repairs or replacement of premature rusted fender(s), pursuant to Paragraph C of Section I of this Order.

I. All communications between respondent and any zone representative, dealer or past or current owner concerning removal and replacements or reimbursements for repairs or replacements made to Honda automobiles affected by premature rusting. Such documents shall include, but not be limited to (a) all written communications; and (b) all oral communications which are reduced to writing and maintained in the ordinary course of business.

J. Each instance arising under Paragraph C of Section I of this Order where respondent reimbursed a past or current owner of a

Honda automobile for less than one hundred percent (100%) of the actual charges for parts and labor, and those documents revealing the underlying basis for determining the usual and customary charges in each such instance.

K. Each instance arising under Paragraphs B or C of Section I of this Order involving a dispute over months-in-service or ownership within the first thirty-six (36) months, unless respondent determined to remove and replace front fenders, make a cash settlement or reimburse an owner in accordance with said paragraphs, notwithstanding said dispute.

L. Each instance arising under Paragraph B of Section I of this Order where respondent failed to remove and replace the front fenders of any Honda automobile, and the underlying basis for each such failure. Such documents shall include all written reports required by Paragraph B of Section I of this Order.

M. Each instance arising under Paragraph C of Section I of this Order where respondent failed to reimburse any past or current owner, and the underlying basis for each such failure.

N. The number of one-side galvanized fenders used by respondent for replacements and the underlying basis for the unavailability of fenders treated with a zinc coating process similar to zincrometal.

V

It is further ordered, That respondent shall notify the Commission at least thirty (30) days prior to any proposed change in its structure, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation, which may affect compliance obligations arising out of this Order.

VI

It is further ordered, That respondent shall, within sixty (60) days after the date of service of this Order, and at one year intervals thereafter through 1983, file with the Commission a report, in writing, signed by respondent, setting forth in detail the manner and form in which it has complied and will comply with this Order.

— ATTACHMENT A — AMS 3061 8107

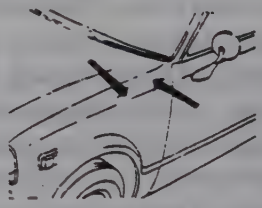
HONDA

AMERICAN HONDA MOTOR CO., INC.
100 WEST ALONDRA BOULEVARD, GARDENA, CALIFORNIA 90247
AUTOMOBILE SERVICE DEPARTMENT, P.O. BOX 80 - GARDENA, CALIF.
CABLE ADDRESS - AMEHON, GARDENA, CALIFORNIA (213) 327-8280

IMPORTANT: FREE FENDER REPLACEMENT OFFER

Dear Honda Owner:

We have become aware of a condition in some Honda cars which you should know about. This condition may result in the front fenders of some 1975—1978 cars rusting prematurely. By agreement with the Federal Trade Commission, American Honda will correct this problem free, if you qualify. If we cannot replace the fenders within six months of when you apply (see paragraph 3), we will offer you the option of receiving a cash settlement (see paragraph 4). Also, if you paid for repair or replacement of rusted fenders in the past, American Honda will repay you, if you qualify. We are doing this because we want to satisfy our customers and keep them satisfied.



Please read this letter carefully and follow the steps listed to make sure you get the new fender(s) or refund. We are sorry this letter is so long, but we want to make sure you have all the information you need.

HONDA'S PROGRAM FOR FRONT FENDER RUST

1. How to Tell If Your Car Has The Front Fender Rust Condition

This program covers rust on the top part of the front fender, within about two feet of the windshield. The rust first appears in the form of bubbles or blisters in the paint. Soon after, holes in the metal develop. The drawing above shows the problem area.

Only rust which began on the underside of the fender is covered by this program. Conditions *not* covered are:

a. rust on any other part of your car;
b. surface rust;
c. rust due to unrepaired (or poorly repaired) stone chips or collision damage.

2. How to Determine If You Qualify For The Replacement Program

We will replace the rusted fender(s) free, if you meet *all* of these conditions:

a. Your car is a 1975, 1976, 1977 or 1978 Honda, any model;
b. The rust began on the underside of the fender and is in the top, rear part of the front fender (see the drawing);
c. The first signs of rust (usually paint bubbling) appeared within your car's first three years of service. See the dates at the top of the enclosed Application Form. If you first noticed the problem before the "ended" date, you qualify; and
d. You now own (or lease) the car, and owned (or leased) it at some time during its first three years.

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3. What You Should Do If You Meet These Qualifications — How to Apply

a. Visit any Honda new car dealer any time during normal service hours to get your car's fenders inspected. *You must* bring the Application Form with you. (If you lost it, contact your local Honda zone office listed at the end of this letter.) Although the inspection should only take a few minutes, you may want to call the dealer before coming, to avoid possible delays. If the dealer agrees after inspecting your car that you qualify, an appointment will be set for your fender replacement.

b. At the inspection, the dealer will ask you to sign the statement in the "Replacement" section of the Application Form. This certifies that the rust appeared within your car's first three years, and that you owned it at some point during those three years. The dealer will fill in the inspection and appointment dates on your Form. He will also fill in a date exactly six months from the inspection. If the dealer cannot install your new fender(s) by this six-months date, you have the right to a cash settlement (see paragraph 4 below). *Be sure* to keep your copies of the Form. Mark the date on your calendar so that you know when the six months have passed.

c. If the dealer says that you do not qualify, ask him for a copy of his inspection report. If you still think you qualify, you have the right to get a review of your case by a Honda zone representative. Contact your local Honda zone office. If the dealer's report says you do not qualify because the rust did not begin on the underside of the fender, you can ask the zone office to do another inspection.

d. Bring your Application Form with your car to the dealer on your appointment date. The fender(s) will be replaced at no charge to you. Because of the time needed for the paint to dry, it will usually take three or four working days to replace the fender(s). In some cases, it may take even longer. Ask your dealer. Also, you should know that it is not always possible to match exactly the fender paint or accent items. If you cannot make your appointment, call your dealer well in advance to reschedule it.

4. If The Dealer Can't Replace The Fender(s) Within Six Months

If we receive many requests for new fenders under this Program, your dealer may not be able to install your new fender(s) within six months of the inspection date. If your fenders have not been installed by the six-months date on the Application Form, you will have a choice. You can either wait to have the fender(s) replaced when the dealer can schedule the work, or you can receive a check from us for $150 for each rusted fender.

It is *very important* that you keep your copies of the Application Form and mark the six-months date on your calendar. Then, on that date, or as soon as possible after that, make your choice. If you want to wait to get your fender(s) replaced, call your dealer to set an appointment. If you choose instead to take the money, fill out and sign the "Cash Settlement" section of the Application Form, and mail the white copy to us in the enclosed envelope. We will then mail you a check within 60 days. Only one cash settlement per automobile is permitted.

Remember, you don't have to accept the $150 per fender. If you prefer, you can choose to wait and have your fender(s) replaced. You *cannot* get both new fenders and the money. The $150 will only be offered if the dealer can't replace the fender(s) within six months. If you miss an appointment and do not reschedule it within the six months you become ineligible for the cash settlement. You should also know that a body shop would probably charge you more than $150 to replace your fender. If you lose your Application Form call the dealer who did your inspection.

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5. **What You Should Do If You Already Paid For Repairs or Replacement — Before You Got This Letter**

We will repay you for reasonable repair or replacement bills which you paid in trying to fix the rusted fender(s). *But*, we will repay you only if you had the repairs or replacement *before* you got this letter.

To get repaid, you must:

a. Meet all the conditions in paragraph 2, *except* you are still eligible even if you don't own the car anymore.
b. Carefully read the statement in the "Repayment" section of the Application Form and sign it. Also, fill in the amount you spent for the repairs or replacement.
c. Send the pink copy of the Form to us in the enclosed envelope, along with a copy of your repair or replacement bill. If you don't have your bill, try to get a copy from the repair shop. If you can't get a copy of the bill, send us a copy of your cancelled check or charge receipt, and a statement from the repair shop describing the repair or replacement and the cost, if you can get one. If you can't, send us the name and address of the repair shop and the date of repair, so we can check the information.
d. We will then repay you within 60 days. If you still own the car, we may ask to inspect it before we repay you. This offer cannot be transferred to anyone else.

6. **IMPORTANT REMINDERS**

Act promptly. After you find that your car has front fender rust, contact a Honda dealer right away. This program will end May 1, 1983. BUT YOU MUST APPLY BEFORE (six months after Order served), OR YOUR CAR IS 3 1/2 YEARS OLD, WHICHEVER DATE IS LATER, TO BE ELIGIBLE.

Although there is no guarantee, the new fender(s) which we will give you should not develop this type of rust for at least three years, whether or not you have them "rustproofed." The fenders have been factory-treated to resist rust. However, the metal may rust eventually. The effectiveness of rustproofing will depend on many factors. Before purchasing rustproofing, you should consider the age and general condition of your car and how much longer you plan to keep it. Also, keep in mind that you will be charged the rustproofer's regular price if you decide to purchase it. In this instance, we would not generally recommend it.

If you have any questions or problems with our program, call or write your local Honda zone office listed on the next page. We deeply regret any inconvenience this rust condition or our program may cause you.

Sincerely,

AMERICAN HONDA MOTOR CO., INC.

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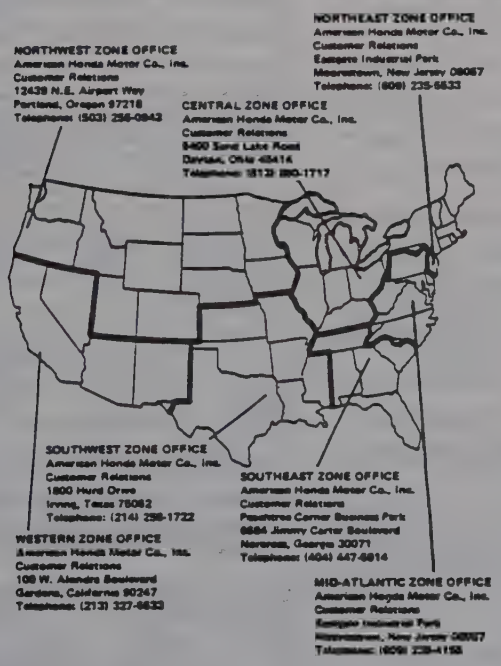
If you are dissatisfied with the service you received at an authorized Honda dealership, you should review the matter with that dealership's Service Manager. This will normally resolve your problem. If it does not, you should appeal the decision with the owner of the dealership.

After following these steps, if you wish to obtain assistance from American Honda you should contact the appropriate Zone Office. The Zone Office to contact is the one covering the area where you are now located. Each Zone's address and area of responsibility is shown on the map.

Please include the following information when you contact the Zone Office:

1. Vehicle Identification Number (VIN)
2. Date of Purchase
3. Servicing Dealer Name and Address
4. Your Name and Address

The Zone Office is staffed to assist Honda owners.



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HONDA

— Attachment B —

1975—78 FENDER RUST APPLICATION FORM

AMS 2418-3466

You must bring all copies of this form to your dealer when you have the car inspected.

31

PRE-PRINTED

Write Name/Address Corrections here:

3 years-in-service began PRE-PRINTED ; ended PRE-PRINTED

Complete and sign the applicable sections:

I. REQUEST REPLACEMENT

I request that one ☐, or both ☐ front fenders be replaced. I certify that fender rust or bubbling appeared within my car's first three years-in-service and that I owned or leased the car during that period, and still own or lease it.

(Owner's Signature) (date)

Date car inspected: (date)

Six months from that date is: (date)

Repair appointment: (time) (date)

Dealer Name/Number

(Dealer's Verification Signature) (date)

II. REQUEST CASH SETTLEMENT

My fenders could not be replaced by (6 months date)

Therefore, I request a cash settlement of:

☐ $150 (one rusted fender) or ☐ $300 (two rusted fenders)

(Owner's Signature) (date)

Mail white copy to American Honda.

III. REQUEST REPAYMENT

I paid $ to have my rusted front fender(s) repaired before I received the letter from American Honda. Therefore, I request repayment for that amount. I certify that the rust began on the underside of the fender, and appeared within my car's first three years-in-service and that I owned or leased the car during that period.

(Owner's Signature) (date)

NOTE: To request repayment, you must enclose a copy of the paid repair bill or other proof of repair and mail it with the pink copy of the form to American Honda.

This column for AHM/Dealer Use Only:

CLAIM NO.	DEALER NO.	REPAIR CODE
MODEL V.I.N.		
DEALER R.O. NO.	DEALER R.O. DATE	DATE WORK COMPLETED
AIR CONDITIONER MANUFACTURER		SERIAL NO.

Which fender replaced? LEFT BOTH RIGHT

HONDA/C	QTY.	PARTS DESCRIPTION	DLR. NET

(A) DEALER NET PARTS TOTAL	DOES NOT INCLUDE HANDLING	
(B) PARTS HANDLING		
(C) SUBLET		
SUB TOTAL	Lines A & C	
(D) LABOR	TOTAL F.R.T.	$ –
(E) CLAIM TOTAL		

SUBLET WORK EXPLANATION SUBLET INVOICE NO.

DEALER CERTIFICATIONS

DEALER HEREWITH CERTIFIES THAT ALL PARTS AND/OR LABOR DESCRIBED HERE WERE FURNISHED AT NO CHARGE TO THE CUSTOMER PURSUANT TO AMERICAN HONDA MOTOR COMPANY INC. WARRANTY POLICIES. ALL CREDITED ITEMS SUBJECT TO AUDIT AND PARTS RETURN.

SERVICE MANAGER SIGNATURE

FACTORY COMMENTS

AHM SIGNATURE

AUTHORIZATION SIGNATURE DATE

CODES: A ☐ B ☐ C ☐ D ☐ E ☐

COPIES: WHITE OWNER MAILS TO HONDA FOR CASH SETTLEMENT or DEALER MAILS TO HONDA FOR FENDER CLAIM PINK OWNER SENDS TO HONDA FOR REPAYMENT GREEN DEALER INSPECTION COPY GOLD OWNER COPY YELLOW DEALER COPY

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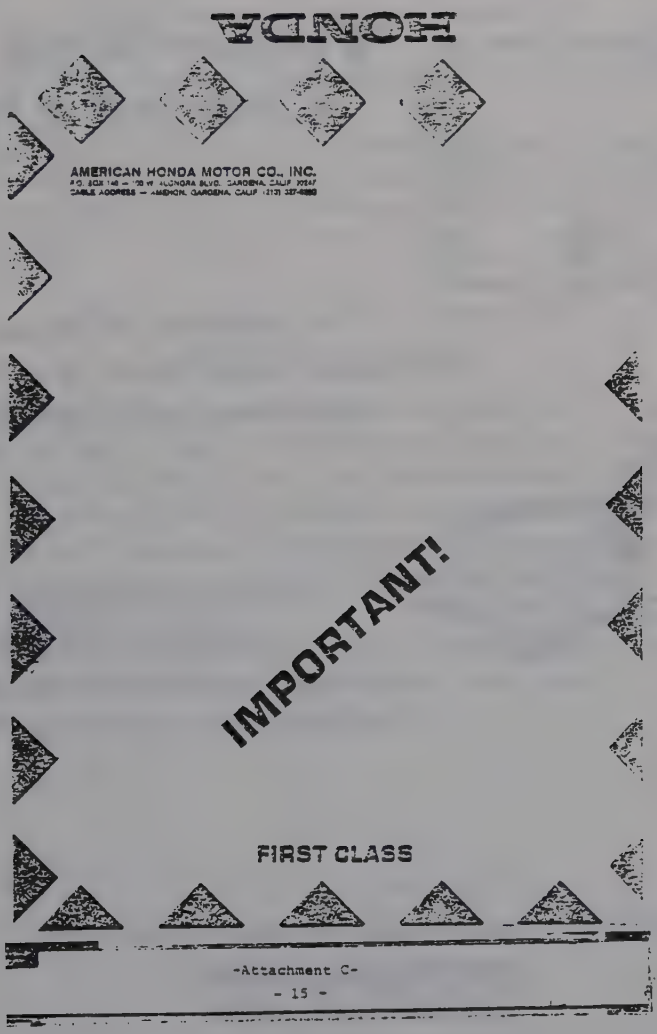

-Attachment C-

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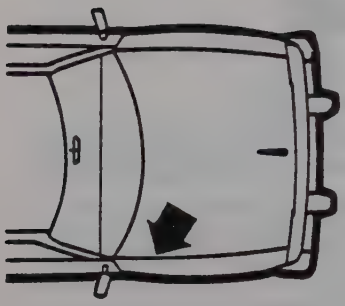
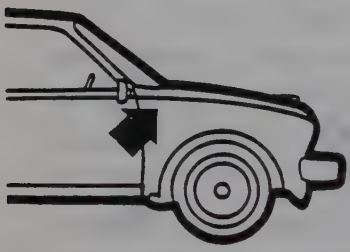
ATTACHMENT D



Fender Rust Covered Free

If your 1975—78 Honda car front fender rusted in this area in its first three years of operation,



you may be eligible for a free replacement fender (or a refund for your costs, if you've already had it repaired).

Ask your Honda dealer for more information.

HONDA

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In The Matter Of

ABC VENDING CORPORATION, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 7652. Order, Oct. 22, 1964—Modifying Order, Jan. 28, 1982

This order reopens the proceeding and modifies the Commission's order issued on October 22, 1964, 66 F.T.C. 1019, by deleting Paragraph VIII from the order, which limited the amount of time respondents could contract for exclusive concessionary rights at movie theaters.

ORDER MODIFYING CEASE AND DESIST ORDER ISSUED OCTOBER 22, 1964

The Federal Trade Commission having considered the September 22, 1981 petition of Ogden Food Service Corporation (successor to ABC Vending Corporation) to reopen this matter and to set aside or, in the alternative, modify the consent order to cease and desist issued by the Commission on October 22, 1964, and having determined that changed conditions of fact warrant reopening and modification of the order,

It is ordered, That this matter be, and it hereby is reopened and that Paragraph VIII of the Commission's order be and it is hereby deleted.

IN THE MATTER OF

D'ARCY-MACMANUS & MASIUS, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 AND 12 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3083. Complaint, Feb. 12, 1982—Decision, Feb. 12, 1982

This consent order requires a St. Louis, Missouri advertiser, among other things, to cease disseminating advertisements for any denture product, toothache drop or gel, which contain representations that contradict or negate the health, safety or efficacy statements appearing on the product's label. Any claims regarding the duration of use of such products trigger a disclosure of any labeling warning. The order further requires that any representation that Snug Denture Cushions can be worn "for weeks" or any other period of time, must be accompanied by a statement that denture cushions should only be used "temporarily, until a dentist can be seen."

Appearances

For the Commission: *Leslie E. Rossen.*

For the respondent: *Stuart L. Friedel, Davis & Gilbert,* New York City.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that D'Arcy-MacManus & Masius, Inc. ("D'Arcy-MacManus"), a corporation, hereinafter referred to as respondent, has violated the provisions of the Federal Trade Commission Act, and that a proceeding with respect to such violations would be in the public interest, hereby issues its complaint, setting forth its charges as follows:

PARAGRAPH 1. D'Arcy-MacManus is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal office and place of business located at One Memorial Drive, St. Louis, Missouri.

PAR. 2. Respondent D'Arcy-MacManus is now and has been an advertising agency of Mentholatum. It has, in the past, and is now engaged in the preparation for publication, dissemination and distribution of advertising materials, including but not limited to the advertising referred to herein to promote the sale of Snug Denture Cushions.

PAR. 3. In the course and conduct of its business, respondent has

disseminated or caused the dissemination of various advertisements for Snug Denture Cushions across state lines by various means in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, including advertisements inserted in magazines and newspapers and also advertisements broadcast on national television networks. The purpose of all these advertisements has been to induce, directly or indirectly, the purchase of Snug Denture Cushions, and it is likely that these advertisements have succeeded in inducing consumers to purchase this product.

PAR. 4. Typical, but not all inclusive, of the statements and representations in said advertisements are those found in Exhibits A–G attached to this complaint, including such representations as the following:

a. Newspaper and magazine advertisements

(1) ELIMINATES DAILY DENTURE 'FIXINGS' FOREVER-Snug Cushions hold dentures comfortably tight for weeks.

(2) HOLDS DENTURES FIRM WITHOUT DAILY 'FIXINGS'-Snug Cushions hold dentures comfortably tight for weeks.

(3) NEW FREEDOM FROM DAILY DENTURE 'FIXINGS'-Snug Cushions hold dentures comfortably tight for weeks.

b. Television advertisements

(1) Sara: Didn't I tell you about Snug? It's different—you don't need to apply it everyday . . . Snug lasts for weeks. And it'll hold your dentures firm and comfortable. . . . At a point later in time Sara: Didn't you switch to Snug? Helen: Sure . . .

(2) Thousands of denture wearers have long suffered with loose, wobbly, uncomfortable plates. Now many use Snug Brand Denture Cushions. . . .

PAR. 5. Through the use of said advertisements and others similar thereto not specifically set out herein, disseminated as aforesaid, respondent has made or is making the following representations:

(a) that Snug Denture Cushions are appropriate for long term use;

(b) that Snug Denture Cushions are for use other than temporary use only until a dentist can be seen.

PAR. 6. In fact, the labeling on Snug Cushions states:

(a) On the package:

Caution: Long term use of an ill-fitting denture, reliner, pad or cushion may lead to swelling, faster bone resorption, or continuing irritation. Use Snug temporarily until you can see your dentist.

(b) On the package insert:

(1) Snug Denture Cushions are for *temporary* use only. . . .

(2) Dentures that do not fit properly cause irritation and injury to the gums and faster bone loss which is permanent and may require a completely new denture. Changes in the gums caused by dentures that do not fit properly may require surgery for correction. Continuing irritation and injury may lead to tumors in the mouth. Use of denture reliners, pads, and cushions may temporarily decrease the discomfort. However, their use will not make the denture fit properly. Special training and tools are needed to fit properly. You must see your dentist for a new denture or a repair as soon as possible.

PAR. 7. The representations referred to in Paragraph Five are inconsistent with, negate, and contradict the labeling on respondent's product as set forth in Paragraph Six hereof. Such inconsistency, negation, and contradiction has the tendency and capacity to mislead and deceive purchasers of said product as to its proper duration of use, and to negate the import and purposes of and to detract from the effectiveness of the warnings, cautions, limitations and instructions for use found in the labeling.

Therefore, the advertisements, acts and practices, referred to in Paragraph Five above were and are unfair and deceptive.

PAR. 8. Furthermore, in their advertising for Snug Denture Cushions, respondent has been and now is making claims as to the duration of use of said product without clearly and conspicuously disclosing to the purchasing public that the labeling for Snug Denture Cushions states that said product should be used only on a temporary basis until a dentist can be seen.

PAR. 9. The existence and substance of the above-mentioned labeling warning is a material fact in light of the representations set forth in Paragraphs Four and Five regarding duration of use, in that disclosure of the warning to consumers would be likely to affect their decisions of whether or not to purchase said product and of how properly to use it. Respondent's failure to disclose this material fact has the tendency and capacity to mislead and deceive consumers into the mistaken belief that no such warning exists.

Therefore, the advertisements, acts and practices referred to in Paragraphs Four and Five above were and are false, deceptive, and unfair.

PAR. 10. In the course and conduct of aforesaid business, and at all times mentioned herein, respondent D'Arcy-MacManus has been, and now is, in substantial competition in commerce with other advertising agencies.

PAR. 11. The aforesaid unfair and deceptive acts and practices of respondent have had and now have, the capacity to induce members of the purchasing public to purchase substantial quantities of said product.

PAR 12. The aforesaid acts and practices of respondents, as herein alleged, were and are all to the prejudices and injury of the public and of respondent's competitors and constituted and now constitute, unfair and deceptive acts and practices and unfair methods of competition in or affecting commerce, in violation of Sections 5 and 12 of the Federal Trade Commission Act. The acts and practices of respondents, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

SNUG DENTURE CUSHIONS
SNUG
BRAND
DENTURE CUSHIONS
Ever-soft Plastic Cushions
For Upper or
Lower Plates
Contents
2 Cushions
THE MENTHOLATUM CO., BUFFALO, N.Y. 14213

Page 1

Masius, Wynne-Williams, Street & Finney, Inc. EDITORIAL DEPARTMENT

IDENTIFICATION NO.

ADVERTISER The Mentholatum Company

FOR SNUG DENTURE CUSHIONS
"POWDERS & STICKUPS" (A)
(#SN-11-30C)

DATE August 22, 1969

JOB NO. 1COTV33
As filmed: 8/19/69
As recorded: 8/22/69

VIDEO	AUDIO
1. OPEN ON CAN OF ADHESIVE POWDER, POURING POWDER ONTO LIMBO SURFACE.	1. ANNCR: (VO) Some people with lo wobbly dentures—
2. PULL BACK - ACTION CONTINUES.	2. ANNCR: (VO) use adhesive powde: every morning and
3. HAND SETS CAN ON SURFACE BEHIND SPRINKLE OF POWDER.	3. ANNCR: (VO) every night.
4. BESIDE PILE OF POWDER, RIBBON OF ADHESIVE CREAM IS SQUEEZED OUT ONTO LIMBO SURFACE.	4. ANNCR: (VO) Others use creat
5. TUBE OF CREAM IS SET DOWN BEHIND RIBBON. NOW BOTH PRODUCTS AND THEIR CONTENTS ARE SEEN SIDE BY SIDE.	5. ANNCR: (VO) day after day.
6. THE CAN AND PILE OF POWDER POPS OFF.	6. ANNCR: (VO) But some never both
7. THE TUBE AND RIBBON OF CREAM POP OFF.	7. ANNCR: (VO) with daily fitting--
8. CU PKG OF SNUG.	8. ANNCR: (VO) they line their de with Snug Brand De Cushions.
9. PULL BACK AS HAND REMOVES CUSHION WITH BOTH LINENS ON FROM BOX. SUPER: "LASTS FOR WEEKS".	9. ANNCR: (VO) One lining lasts f weeks.
10. WITH ONE LINEN ON BACK, SHOWING SNUG CUSHION ON TOP, HAND BEGINS TO CUT SHAPE OF DENTURE.	10. ANNCR: (VO) Apply Snug at home minutes.

IDENTIFICATION NO. DATE August 22, 1969

ADVERTISER The Menthelatum Company JOB NO. 100T733

FOR SNUG DENTURE CUSHIONS As filmed: 8/19/69
As recorded: 8/22/69

"POWDERS & STICKUMS" (A)
(#SN-11-30C)

Page 2.

VIDEO	AUDIO
11. NOW "U" SHAPE OF DENTURE IS HELD IN HAND, WHILE BACKING LINEN IS REMOVED. SUPER: "HOLDS DENTURES TIGHT".	11. ANNCR: (VO) It holds dentures tight
12. HAND FLEXES CUSHION.	12. ANNCR: (VO) and cushions the gum lasts for weeks
13. CUT BACK TO SET UP OF POWDER AND CREAM WITH CONTAINERS.	13. ANNCR: (VO) without daily fixing
14. POWDER IS POPPED OFF.	14. ANNCR: (VO) Try the no-mess
15. CREAM IS POPPED OFF.	15. ANNCR: (VO) no-bother way ...
16. CU SNUG PACKAGE. SUPER: "HOLD DENTURES TIGHT". THEN POP ON: "2 CUSHIONS $1.50".	16. ANNCR: (VO) get Snug to hold dentures tight.

SNUG DENTURE CUSHIONS

TELEVISION COMMERCIAL, 1976-77
"SPOKESMAN"

1. SPOKESMAN: (DV) What do you use to hold loose wobbly dentures comfortably tight?

2. Powder?

3. Cream?

4. Or long-lasting Snug Brand Denture Cushions.

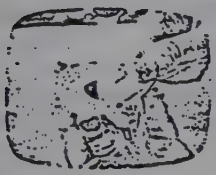
5. Snug is a cushion –

6. not only holds plates tight, but makes them feel so comfortable.

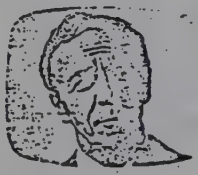
7. (VO) Easy to fit...

8. Snug sticks to your plates... lasts for weeks...

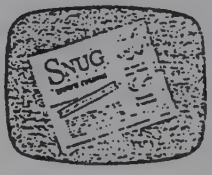
9. so no daily fixing...no mess... no after taste.



10. Easily cleaned or removed.



11. (DV) To hold dentures comfortably tight for weeks ...



12. (VO) get Snug Denture Cushions!

MASTUS, WYNNE-WILLIAMS INC.

CLIENT THE MENTHOLATUM COMPANY

TITLE "SPOKESMAN" (C) (ØMVSN2123)
:30 TV COMM'L.

DATE SEPT. 15, 1972

70 w

SNUG DENTURE CUSHIONS
As Produced: 8/30/72
As Filmed: 8/17/72

OPEN ON CU SPOKESMAN	SPOKESMAN (OC): What do you use to hold loose, wobbly dentures comfortably tight?
CUT TO CU AS HE SHAKES POWDER ON HIS PALM	Powder?
CU AS HE SQUEEZES CREAM ON PALM	Cream? Or long-lasting
CUT TO CU SNUG PKG AS HE PICKS IT UP	Snug Brand Denture Cushions.
HOLD CU AS HANDS SLIP OUT SNUG	Snug is a cushion --
PULL BACK TO MCU MAN	not only holds plates tight...but makes them feel so comfortable.
CUT TO CU MAN'S HANDS CUTTING SNUG INTO SHAPE WITH SCISSORS	Easy to fit...
DISS TO HIS HANDS FITTING U-SHAPED SNUG ONTO CLEAR LUCITE U-SHAPE	Snug sticks to your pla lasts for weeks...so no daily fixing...no mess. no after-taste.
PAN AS HIS HANDS SCRUB SNUG ON LUCITE U-SHAPE, WITH TOOTHBRUSH UNDER RUNNING FAUCET	Easily cleaned or remov
CUT TO CU MAN	To hold dentures comfortably tight for week
CUT TO CU SNUG PKG	get Snug Denture Cushio

SNUG DENTURE CUSHIONS

TELEVISION COMMERCIAL, "SPOKESWOMAN"

1. SPOKESWOMAN: (DV) Thousands of denture wearers have long suffered

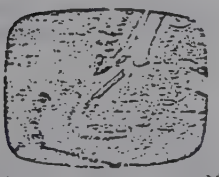
2. with loose, wobbly, uncomfortable plates.

3. Now many use Snug Brand Denture Cushions and

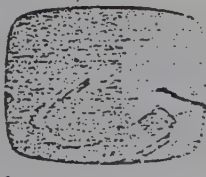
4. are so grateful for the way Snug holds dentures tight...

5. and being a cushion, Snug makes dentures feel so comfortable.

6. (VO) Easy to fit ...

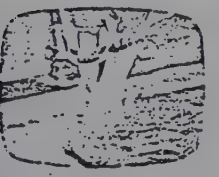


7. Snug sticks to your plates... lasts for weeks ...



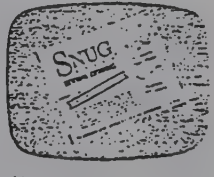
8. so no daily fixing .. no mess .. no after-taste.

9. (SFX) Easily cleaned



10. or removed.

11: (DV) To hold dentures comfortably tight for weeks...



12. (VO) get Snug Denture Cushions.

MASIUS, WYNNE-WILLIAMS INC. · Page 2

CLIENT THE MENTHOLATUM COMPANY

TITLE "SPOKESWOMAN" (C) (ØMVSN2133)
:30 TV COMM'L

DATE SEPT 15, 1972

75 w

SNUG DENTURE CUSHIONS
As Produced: 8/30/72
As Filmed: 8/17/72

OPEN ON CU SPOKESWOMAN	SPOKESWOMAN (OC): Thousands of denture wearers have long suffered with loose, wobbly, uncomfortable plates.
SHE PICKS UP SNUG PKG	Now many use...
CUT TO CU PKG IN HER HAND	Snug Brand Denture Cushion and are so grateful
CUT TO CU WOMAN	for the way Snug holds dentures tight...and being a cushion, Snug makes dentures feel so comfortab
CUT TO CU WOMAN'S HANDS CUTTING SNUG INTO SHAPE WITH SCISSORS	Easy to fit...
CLOSS TO HER HANDS FITTING U-SHAPED SNUG ONTO CLEAR LUCITE U-SHAPE	Snug sticks to your plates lasts for weeks... so no daily fixing...no mess... no after-taste.
PAN AS HER HANDS SCRUB SNUG ON LUCITE U-SHAPE, WITH TOOTHBRUSH UNDER RUNNING FAUCET	Easily cleaned or removed.
CUT TO CU WOMAN	To hold dentures comfortabl tight for weeks...
CUT TO CU SNUG PKG	get Snug Denture Cushions.

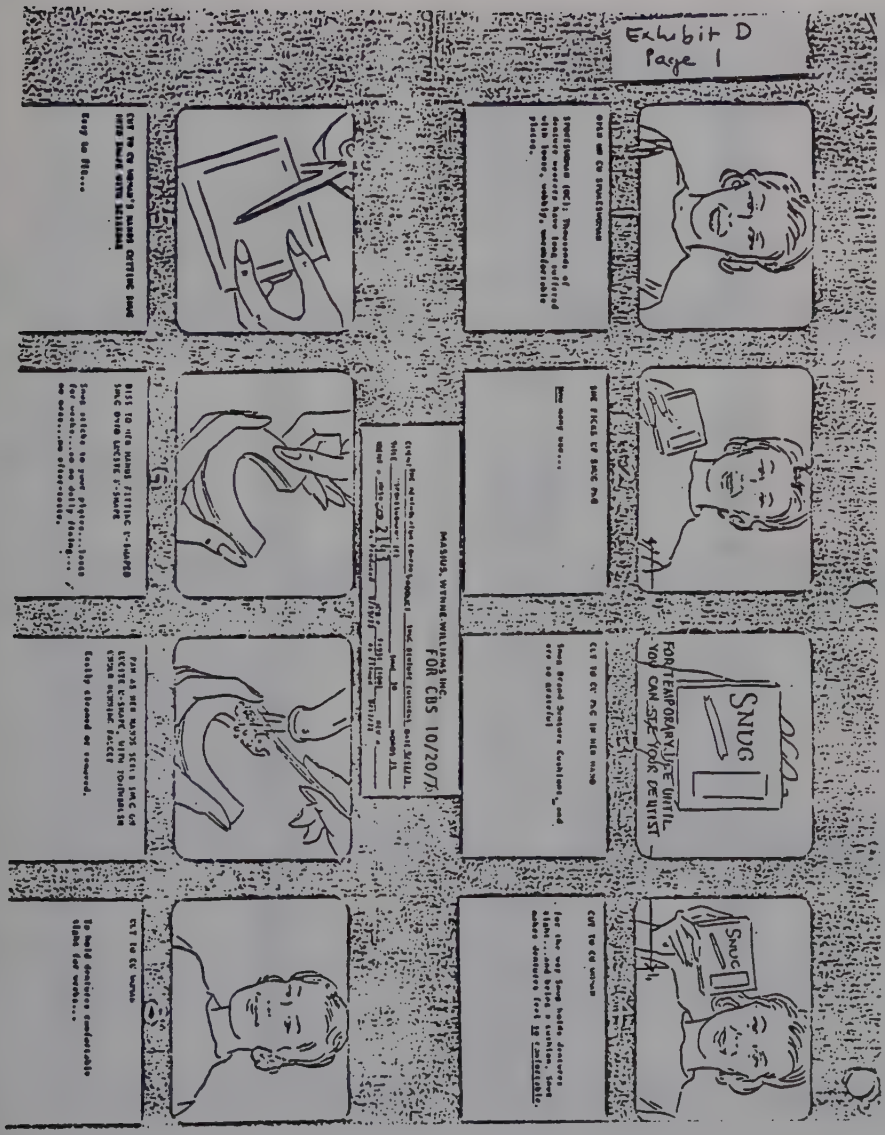


Exhibit D
Page 1
SNUG
FOR TEMPORARY USE UNTIL YOU CAN SEE YOUR DENTIST
MASIUS, WYNNE-WILLIAMS INC.
FOR CBS 10/20/7

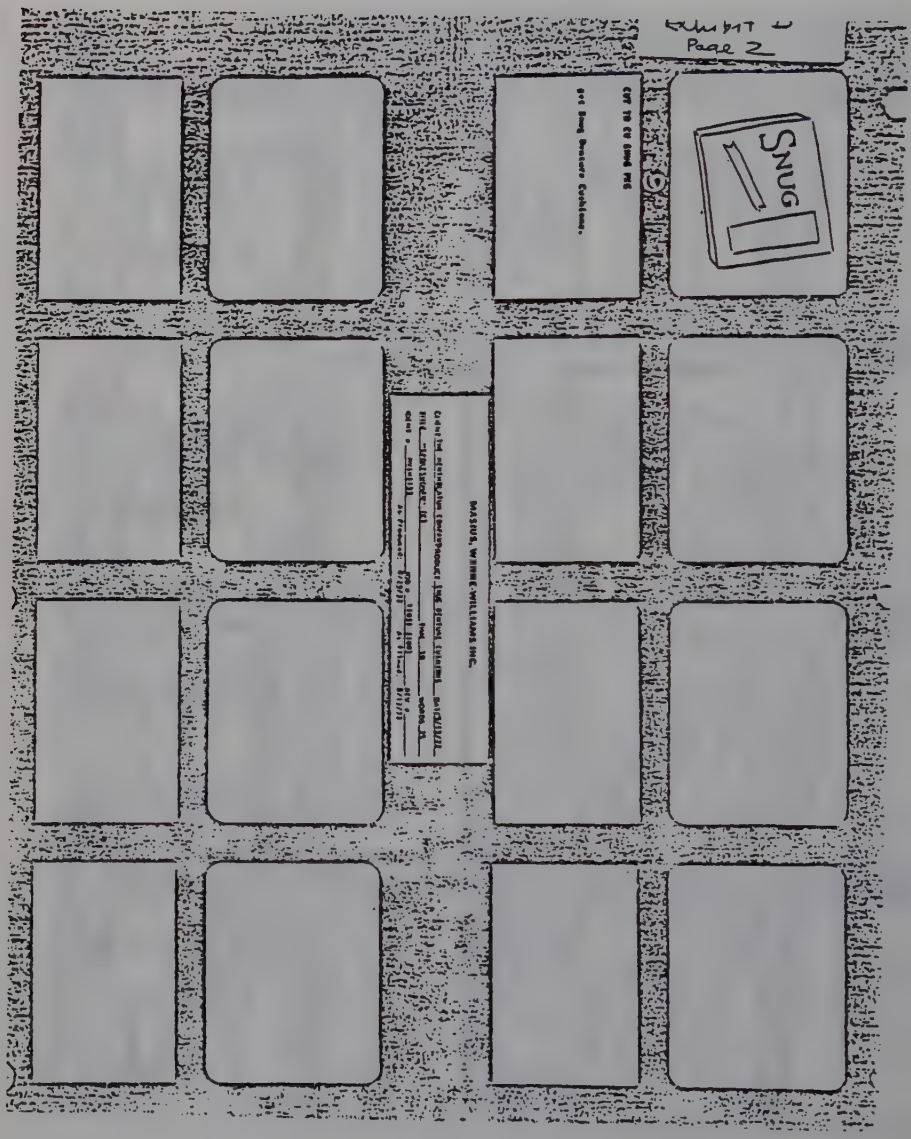


Exhibit D
Page 2
SNUG
CUT TO CO DWG NO
DASHUN, WARNER WILLIAMS INC.

Amazing soft plastic cushion

holds dentures comfortably tight for weeks

without messy "stickums"

Not a paste! Not a powder! Not a cream or wax pad! But amazing soft plastic adhesive cushions that hold loose, wobbly dentures comfortably tight and firm. Snug® Brand Denture Cushions are the long-lasting, clean way to hold loose dentures tight. Snug lasts for weeks . . . does away with bothersome mess of daily "fixing." Snug Cushions are easy to shape and fit . . . stick to your plate not to your gums. Easy to clean or remove . . . won't wash off and can't flake away. Get Snug Denture Cushions to hold your dentures tight for weeks . . . in comfort. At all drug counters.

The Mentholatum Co.—U.S. (Snug) Ad No. SN 75-702
1/20 Page (1⅝ x 3")
Sunday Supplements—1975
Job No. 74-108
Printed in U.S.A.
D'ARCY, MacMANUS & MASIUS, Inc., New York

No paste or powder

holds dentures comfortably tight for weeks

like Snug Denture Cushions

Not a paste! Not a powder! Not a cream or wax pad! But amazing soft plastic adhesive cushions that hold loose, wobbly dentures comfortably tight and firm. Snug® Brand Denture Cushions are the long-lasting, clean way to hold loose dentures tight. Snug lasts for weeks . . . does away with bothersome mess of daily "fixing." Snug Cushions are easy to shape and fit . . . stick to your plate not to your gums. Easy to clean or remove . . . won't wash off and can't flake away. Get Snug Denture Cushions to hold your dentures tight for weeks . . . in comfort. At all drug counters.

The Mentholatum Co.—U.S. (Snug) Ad No. SN 75-704
1/20 Page (1⅝ x 3")
Sunday Supplements—1975
Job No. 74-109
Printed in U.S.A.
D'ARCY, MacMANUS & MASIUS, Inc., New York

Amazing soft plastic cushion

holds dentures comfortably tight for weeks without messy "stickums"

Not a messy paste, powder, cream or wax pad—but an amazing soft plastic adhesive cushion. Snug® Brand Denture Cushions hold loose, wobbly dentures comfortably tight for weeks. With Snug there's no need to bother with messy daily "fixing." It lasts for weeks, sticks to your plate not to your gums, so easy to clean or remove. Get Snug Denture Cushions to hold your dentures tight and firm for weeks . . . in comfort. At all drug counters.

The Mentholatum Co.—U.S. (Snug) Ad No. SN 75-703
39 lines (1⅝ x 29")
Sunday Supplements—1975
Job No. 74-108A
Printed in U.S.A.
D'ARCY, MacMANUS & MASIUS Inc., New York

No paste or powder

holds dentures comfortably tight for weeks like Snug Denture Cushions

Not a messy paste, powder, cream or wax pad—but an amazing soft plastic adhesive cushion. Snug® Brand Denture Cushions hold loose, wobbly dentures comfortably tight for weeks. With Snug there's no need to bother with messy daily "fixing." It lasts for weeks, sticks to your plate not to your gums, so easy to clean or remove. Get Snug Denture Cushions to hold your dentures tight and firm for weeks . . . in comfort. At all drug counters.

The Mentholatum Co.—U.S. (Snug) Ad No. SN 75-705
39 lines (1⅝ x 29")
Sunday Supplements—1975
Job No. 74-109A
Printed in U.S.A.
D'ARCY, MacMANUS & MASIUS, Inc., New York

LIMINATES DAILY
ENTURE "FIXINGS"
FOREVER

vg Cushions hold dentures
:mfortably tight for weeks

more denture "fixings" every morn-
with messy powders or creams. Even
ur dentures need "fixing" after every
l, here's important news. Snug grip-
t cushions restore your dentures'
ding power so dentures stay comforta-
ightly for weeks. Snug, the soft, effec-
temporary aid, actually forms a
ulous bond" between dentures and
s. Sticks to dentures, not to gums.
can rinse, scrub or soak Snug fresh
clean. It's easy to remove . . . but
idesive, washes off or flakes away. So,
daily "fixings"!
Snug, the cushion
holds dentures
mfortably tight
weeks.

SNUG®
DENTURE CUSHIONS

The Hoothuhuhum Co. — U S (Snug) Ad No. SN 77-700
Page 10" x 23"
Sunday Supplementation—1977
Job No. 77-100
Printed in U S A
DARCY MacMANUS & MADIUS, Inc., New York

HOLDS DENTURES
FIRM WITHOUT
DAILY "FIXINGS"

Snug Cushions hold dentures
comfortably tight for weeks

No more denture "fixings" every morning with messy powders or creams. Even if your dentures need "fixing" after every meal, here's important news. Snug grip-tight cushions restore your dentures' holding power so dentures stay comfortably tight for weeks. Snug, the soft, effective temporary aid, actually forms a "comfort bond" between dentures and gums. Sticks to dentures, not to gums. You can rinse, scrub or soak Snug fresh and clean. It's easy to remove . . . but won't dissolve, washes off or flakes away. So, end daily "fixings"!
Get Snug the cushion
that holds dentures
comfortably tight
for weeks.

SNUG®
DENTURE CUSHIONS

The Hoothuhuhum Co. — U S (Snug) Ad No. SN 77-710
Page 10" x 23"
Sunday Supplementation—1977
Job No. 77-100
Printed in U S A
DARCY MacMANUS & MADIUS, Inc., New York

NEW FREEDOM
FROM DAILY
DENTURE "FIXINGS"

Snug Cushions hold dentures
comfortably tight for weeks

No more denture "fixings" every morning with messy powders or creams. Even if your dentures need "fixing" after every meal, here's important news. Snug grip-tight cushions restore your dentures' holding power so dentures stay comfortably tight for weeks. Snug, the soft, effective temporary aid, actually forms a "comfort bond" between dentures and gums. Sticks to dentures, not to gums. You can rinse, scrub or soak Snug fresh and clean. It's easy to remove . . . but won't dissolve, washes off or flakes away. So, end daily "fixings"!
Get Snug the cushion
that holds dentures
comfortably tight
for weeks.

SNUG®
DENTURE CUSHIONS

The Hoothuhuhum Co. — U S (Snug) Ad No. SN 77-711
Page 10" x 23"
Sunday Supplementation—1977
Job No. 77-100
Printed in U S A
DARCY MacMANUS & MADIUS, Inc., New York

LIMINATES DAILY
ENTURE "FIXINGS"
FOREVER

Snug Cushions hold dentures
comfortably tight for weeks

more denture "fixings" every morning with messy
ders or creams. Even if dentures need "fix-
after every meal, here's important news.
cushions restore dentures' holding power
dentures stay comfortably tight for weeks.
Snug, the soft, effective temporary aid, forms a
"comfort bond" between dentures and gums.
Sticks to dentures, not to gums. Rinse, scrub or
soak Snug fresh and clean. Easy to remove,
but won't rub off or flake
away. So, end daily "fixings"!
Use Snug to hold dentures
comfortably tight for weeks.

SNUG®
DENTURE CUSHIONS

The Hoothuhuhum Co. — U S (Snug) Ad No. SN 77-712
Page 10" x 23"
Sunday Supplementation—1977
Job No. 77-100
Printed in U S A

HOLDS DENTURES
FIRM WITHOUT
DAILY "FIXINGS"

Snug Cushions hold dentures
comfortably tight for weeks

No more denture "fixings" every morning with messy powders or creams. Even if your dentures need "fixing" after every meal, here's important news. Snug cushions restore dentures' holding power so dentures stay comfortably tight for weeks. Snug, the soft, effective temporary aid, forms a "comfort bond" between dentures and gums. Sticks to dentures, not to gums. Rinse, scrub or soak Snug fresh and clean. Easy to remove, but won't rub off or flake
away. So, end daily "fixings"!
Use Snug to hold dentures
comfortably tight for weeks.

SNUG®
DENTURE CUSHIONS

The Hoothuhuhum Co. — U S (Snug) Ad No. SN 77-713
Page 10" x 23"
Sunday Supplementation—1977
Job No. 77-100
Printed in U S A

NEW FREEDOM
FROM DAILY
DENTURE "FIXINGS"

Snug Cushions hold dentures
comfortably tight for weeks

No more denture "fixings" every morning with messy powders or creams. Even if your dentures need "fixing" after every meal, here's important news. Snug cushions restore dentures' holding power so dentures stay comfortably tight for weeks. Snug, the soft, effective temporary aid, forms a "comfort bond" between dentures and gums. Sticks to dentures, not to gums. Rinse, scrub or soak Snug fresh and clean. Easy to remove, but won't rub off or flake
away. So, end daily "fixings"!
Use Snug to hold dentures
comfortably tight for weeks.

SNUG®
DENTURE CUSHIONS

The Hoothuhuhum Co. — U S (Snug) Ad No. SN 77-714
Page 10" x 23"
Sunday Supplementation—1977
Job No. 77-100
Printed in U S A
DARCY MacMANUS & MADIUS, Inc., New York

Page 1

D'Arcy-MacManus & Masius

437 MADISON AVENUE
NEW YORK, NEW YORK 10022

Television Continuity

The Mentholatum Co.
ACCOUNT
Snug Denture Cushion
PRODUCT
"Movie"
TITLE
:30
LENGTH
MVSN 2153
SCRIPT NUMBER

As filmed 11/28/77

VIDEO		AUDIO
OPEN ON TWO WOMEN EXITING MOVIE HOUSE ONTO STREET	HELEN:	They don't make movies lik they used to.
WOMEN WALK DOWN STREET	SARA:	Let's have some of my pec pie, that never changes.
CUT TO HELEN'S FACE, LOOKING EMBARRASSED.	HELEN:	Uh-Uh... It's been a while s I fixed my dentures... they' loose again.
2-SHOT AS SARA TALKS TO HELEN.	SARA:	Didn't I tell you about Snug?
ECU OF SNUG PACKAGE. WOMAN'S HAND PULLS CUSHION OUT. SUPER: 'FOR TEMPORARY USE UNTIL YOU SEE YOUR DENTIST."	SARA:	It's different -- you don't n to apply it every day.
CUT TO HAND HOLDING DENTURE SHAPED LUCITE AS OTHER HAND PRESSES SHAPED CUSHION ONTO LUCITE.	SARA:	It's a cushion you just shape
PALM DOWN HAND PRESSES AGAINST TOP OF LUCITE WHICH CLINGS TO HAND WITHOUT ANY OTHER SUPPORT.	SARA:	Snug lasts for weeks. And i hold your dentures firm and comfortable.
DISSOLVE TO SIMILAR SCENE AT A POINT LATER IN TIME.	SARA:	Pecan pie?
	HELEN:	Uh -- Uh --
	SARA:	Didn't you switch to Snug?

Page 2

D'Arcy-MacManus & Masius

437 MADISON AVENUE
NEW YORK, NEW YORK 10022

Television Continuity

The Mentholatum Co.
ACCOUNT

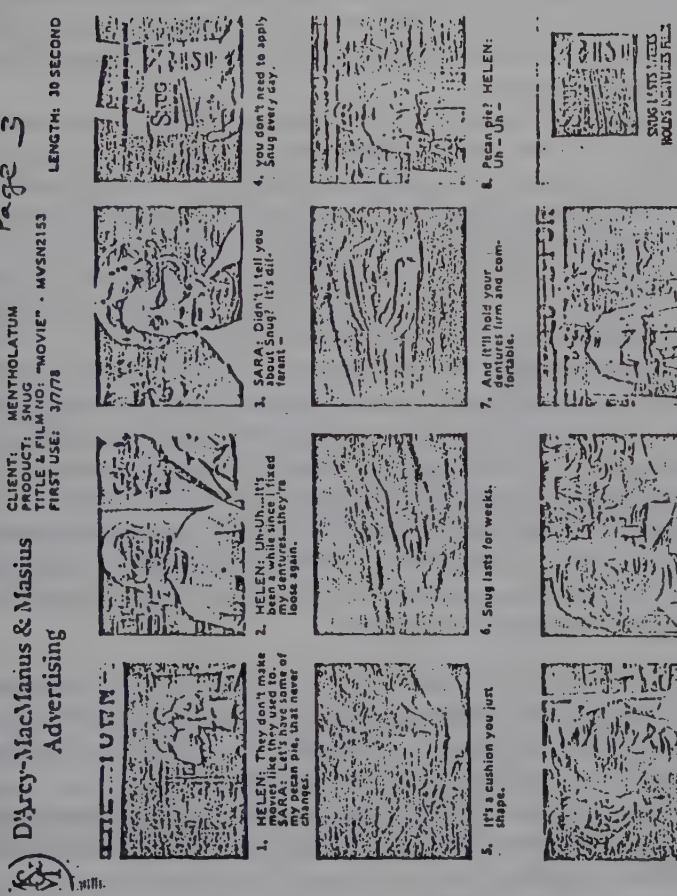
Snug Denture Cushio
PRODUCT

"Movie"
TITLE

:30
LENGTH

MVSN 2153
SCRIPT NUMBER

VIDEO	AUDIO
SCENE CONTINUES	HELEN: Sure --
	SARA: Well?
	HELEN: I'm on a diet.
ECU SNUG PACKAGE	
SUPER: SNUG LASTS WEEKS HOLDS DENTURES FIRM	


D'Arcy-MacManus & Masius
Advertising
Page 3
CLIENT: MENTHOLATUM
PRODUCT: SNUG
TITLE & FILM NO: "MOVIE" - MVSN2153
FIRST USE: 3/7/78
LENGTH: 30 SECOND
1. HELEN: They don't make movies like they used to. SARA: Or pecan pie. Look at my pecan pie, that never changes.
2. HELEN: Uh-Uh...it's been a white lace...I fixed my dentures...they're loose again.
3. SARA: Didn't I tell you about Snug? It's dif-ferent –
4. You don't need to apply Snug every day.
5. It's a cushion you just shape.
6. Snug lasts for weeks.
7. And it'll hold your dentures firm and com-fortable.
8. Pecan pie? HELEN: Uh – Uh –
9. SARA: Didn't you switch to Snug?
10. HELEN: Sure – SARA: Well?
11. HELEN: I'm on a diet. SARA: Oh.
12. (SILENT)

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent D'Arcy-Macmanus is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal office and place of business located at One Memorial Drive, St. Louis, Missouri.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

I.

It is ordered, That respondent, D'Arcy-MacManus & Masius, Inc., a corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device (hereinafter "respondent"), in connection with the advertising, offering for sale, sale or distribution

of any denture product or toothache drops or gel, forthwith cease and desist from disseminating or causing the dissemination of any advertisement by any means in or affecting commerce which makes any representation directly or indirectly that is inconsistent with, negates or contradicts any statement concerning matters of health, safety or efficacy set forth on the labeling of any such product or which in any way limits or qualifies any such statement appearing on the labeling of any such product.

II.

It is further ordered, That respondent, in connection with the advertising, offering for sale, sale or distribution of any denture product or toothache drops or gel (except denture cushions as provided for in Paragraph 3) shall, in disseminating or causing the dissemination by any means in or affecting commerce of an advertisement which makes any representation directly or indirectly (other than those prohibited in I above) regarding duration of use of any such product, disclose clearly and conspicuously any labeling warning regarding duration of use of such a product.

It is agreed, for the purpose of this Order, that in the event a label or packaging warning regarding duration of use is no longer utilized for any such product, advertisements for said product need not bear a disclosure regarding duration of use.

III.

It is further ordered, That respondent, in connection with the advertising, offering for sale, sale or distribution of the product Snug Denture Cushions or any other denture cushion, when making any representation regarding the duration of use of said product (other than those prohibited in I, above), shall disclose clearly and conspicuously that said product is only appropriate for short-term use until a denture wearer is able to see a dentist for the adjustment of his or her loose or ill-fitting dentures. For the purposes of this Order, it is agreed that respondent may use the term "for weeks" in the advertising of denture cushion products so long as the terms "temporary" and "only until a dentist can be seen" are included, and the advertisement does not imply the product should be used on a long term basis.

For the purposes of this order, in the event that the Snug Denture Cushion product is no longer regarded by the Federal Food and Drug Administration as suitable only for short-term, nonregular use, the

respondent may seek from the Commission amendment of this portion of this Order.

IV.

It is further ordered, That respondent shall forthwith distribute a copy of this Order to each of its operating divisions.

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change in its corporate status such as dissolution, emergence of a successor corporation, the creation or dissolution of any subsidiaries, and assignment or sale of the business, or any other change in the corporate respondent that may affect compliance obligations arising out of this Order.

It is further ordered, That respondent shall, within sixty (60) days after this Order becomes final, and annually thereafter for three (3) years, file with the Commission a report, in writing, signed by respondent, setting forth in detail the manner and form in which it has complied with this Order.

In the Matter of

CHRYSLER CORPORATION, ET AL.

MODIFYING ORDER, IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9072. Final Order, Feb. 18, 1981—Modifying Order, Feb. 17, 1982

This order reopens the proceedings and modifies the Commission's order issued on February 18, 1981, 97 F.T.C. 139; 45 FR 70883. The modification sets a single effective date for implementing both sets of retail installment contract revisions.

ORDER REOPENING AND MODIFYING CONSENT ORDER

On February 18, 1981 the Commission issued a Decision and Order against respondents Chrysler Corporation and Chrysler Credit Corporation[1] in connection with the extension and enforcement of motor vehicle retail credit obligations and the disposition of repossessed motor vehicles. There is now before the Commission a request by Chrysler Credit Corporation (filed December 4, 1981) for reopening and modification of that Order pursuant to Section 2.51 of the Commission's Rules of Practice, 16 C.F.R. 2.51.

The Order (Paragraph VI.C) required Chrysler Credit to cease, by February 18, 1982, all use of retail installment contract forms which erroneously state debtors' liability for a deficiency upon repossession. Another provision required such Chrysler Credit contracts to include recitals of debtors' rights to any repossession surplus. Under Paragraph VI.B, contract forms reflecting the latter revision were to be distributed for dealer use within a year after Commission issuance of a final rule or adjudicated order relative to such rights.

Desirous of making the necessary changes at once rather than in successive steps, Chrysler Credit's request asks that April 1, 1982 be fixed as the date for effectuation of both sets of retail installment contract revisions required of it by our February 18, 1981 Order.[2] With respect to deficiency recitals this would involve a delay of approximately six weeks; with respect to the recitals of surplus rights it would advance the required implementation date by an indeterminable number of months.[3]

---

[1] A separate consent order issued simultaneously as to a corespondent, Aurora Chrysler-Plymouth, Inc., is not involved in the modification request addressed herein.

[2] Because the timing of the actions specified in Paragraphs VI.A and D depends on Paragraphs VI.B and C, no modification of Paragraphs A and D is necessary to accomplish Chrysler Credit's desired result. Chrysler Credit has abandoned its request for change of Paragraphs VI.A and D.

[3] Our only adjudicated order concerning repossession surpluses is not yet final. *Francis Ford, Inc. v. FTC*, 654 F.2d 599 (9th Cir. 1980), petition for rehearing pending.

The Commission is of the opinion that the minor six week delay in implementation as to deficiency recitals is more than offset by the benefits of establishing a date certain for Chrysler Credit's effectuation as to surplus rights. The public interest will be served by modifying the Order as requested. *Therefore,*

It is ordered, That Docket 9072 be, and hereby is, reopened for the limited purpose of effecting the following changes in the Order as to Chrysler Credit Corporation.

It is further ordered, That Paragraph VI.B be modified to read as follows:

B. Shall distribute on or before April 1, 1982 the revised retail installment contract forms to all Dealers who use Chrysler Credit installment contract forms.

It is further ordered, That Paragraph VI.C be modified to read as follows:

C. Shall, no later than April 1, 1982, cease and desist the use of any Chrysler Credit retail installment contract form which represents that the debtor may be liable to pay a deficiency where Chrysler Credit knows or should know that it is not entitled under state or federal law to collect a deficiency.

In the Matter of

CHRYSLER CORPORATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3084. Complaint, Feb. 17, 1982—Decision, Feb. 17, 1982

This consent order requires a Highland Park, Mich. motor vehicle manufacturer and distributor, among other things, to cease misrepresenting or failing to disclose the limited applicability of material standards for its oil filters and other products; and failing to have competent and reliable substantiation for claims concerning such standards. The firm is required to notify aftermarket manufacturers, dealers and owners of certain vehicles of the inaccuracy of its oil filter material standard, and provide them with ways to avoid or remedy any resulting problems. Further, all future owner and service manuals must contain accurate oil filter use information. The order additionally requires the company to maintain a reasonably-priced subscription service to provide subscribers with up-to-date material standards; and advertise the existence of this service in *Automotive News.*

Appearances

For the Commission: *Jeffrey M. Karp* and *Arturo Gonzalez-Alfonso.*

For the respondent: *Robert T. Talbot-Stern, Dennis Goschka* and *Judith B. Shumaker,* in-house counsel, Highland Park, Mich.

Complaint

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Chrysler Corporation, a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

Paragraph 1. Respondent, Chrysler Corporation, is a corporation organized, existing and doing business under and by virtue of the laws of the State.of Delaware, with its principal office and place of business located at 12000 Lynn Towsend Drive, Highland Park, Michigan.

Par. 2. Respondent is now, and has been, engaged in the offering for sale, sale, and distribution of vehicles and vehicle parts to the public at retail.

Par. 3. In the course and conduct of its aforesaid business,

respondent causes vehicles and vehicle parts to be shipped to purchasers in various states, and therefore maintains and, at all times mentioned in this complaint, has maintained a substantial course of business, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

PAR. 4. For purposes of this complaint, the following definitions shall apply:

a. *Vehicle* shall mean any automobile, pick-up truck, van, or recreational vehicle;

b. *MMC vehicle* shall mean any vehicle manufactured or assembled by or for Mitsubishi Motor Corporation of Japan, or any subsidiary thereof, and sold by Chrysler Corportion in the United States, but shall not mean any vehicle model presently being manufactured by Chrysler Corporation in the United States or Canada or any successor to such model.

c. *Owner* shall mean any individual, partnership, corporation, or other entity in whose name a vehicle is currently or has been previously registered or titled with the appropriate state authority, including, but not limited to, vehicles held for resale;

d. *Material standard* shall mean any document, excluding drawings, which specifies, in whole or in part, performance or material requirements to be used in the design of a particular part for a vehicle.

PAR. 5. In the course and conduct of its said business, respondent knew or should have known that its various material standards for replacement vehicle parts may have been and may now be utilized by manufacturers of replacement vehicle parts in the design of such parts which are ultimately used or purchased by consumers for their vehicles.

PAR. 6. In the course and conduct of its said business, respondent has disseminated and caused the dissemination of its material standard for oil filters, MS–2999, across the state lines through the United States mail and by other various means in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

PAR. 7. Through MS–2999, referred to in Paragraph Six, respondent represented and now represents, directly or by implication, that:

a. MS–2999 specifies performance and materials requirements for oil filters made for use on each and every vehicle sold by respondent;

b. if an oil filter meets the performance and materials require-

ments specified in MS–2999, that oil filter will not substantially impair the reliability, durability, or performance of any vehicle sold by respondent on which the oil filter was made to be used;

c. if an oil filter meets the 200 p.s.i. hydrostatic burst strength requirement specified in Paragraph D–2 of MS–2999, that oil filter will not substantially impair the reliability, durability, or performance of any vehicle sold by respondent on which the oil filter was made to be used.

PAR. 8. In truth and in fact, contrary to respondent's representations alleged in Paragraph Seven:

a. MS–2999 does not specify performance and materials requirements for oil filters made for use on each and every vehicle sold by respondent;

b. if an oil filter meets the performance and materials requirements specified in MS–2999, that oil filter may nevertheless substantially impair the reliability, durability, or performance of certain vehicles sold by respondent on which the oil filter was made to be used;

c. if an oil filter meets the 200 p.s.i. hydrostatic burst strength requirement specified in Paragraph D–2 of MS–2999, that oil filter may substantially impair the reliability, durability, and performance of certain vehicles sold by respondent on which the oil filter was made to be used.

Therefore, each representation as alleged in Paragraph Seven is deceptive or unfair.

PAR. 9. In the course and conduct of its said business, respondent has disseminated and caused the dissemination of owner's manuals and service manuals for 1971-1980 model year MMC vehicles across State lines through the United States mail and by other various means in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

PAR. 10. By instructing owners of MMC vehicles to "use a high quality filter only" in its MMC owner's manuals and service manuals referred to in Paragraph Nine, respondent represented and now represents, directly or by implication, that any reputable brand of oil filter when used in certain MMC vehicles will not substantially impair the reliability, durability, or performance of such MMC vehicles.

PAR. 11. In truth and in fact, contrary to respondent's representation alleged in Paragraph Ten, certain reputable brands of oil filters when used in certain MMC vehicles may substantially impair the reliability, durability, or performance of such MMC vehicles.

Therefore, the representation as alleged in Paragraph Ten is deceptive or unfair.

PAR. 12. The use on certain MMC vehicles of an oil filter which is not of adequate hydrostatic burst strength may substantially impair the reliability, durability, or performance of such vehicles.

PAR. 13. Respondent knew or should have known of brands and part numbers of replacement oil filters which would not substantially impair the reliability, durability, or performance of certain MMC vehicles, and also knew or should have known of other replacement oil filters on the market which could substantially impair the reliability, durability, or performance of such vehicles.

PAR. 14. Product use and care information which recommends names and part numbers of specific oil filters which are of adequate hydrostatic burst strength to be used on MMC vehicles and which warns that failure to use such filters on MMC vehicles could substantially impair the reliability, durability, or performance of such vehicles, if known to owners, would allow them to avoid substantial economic loss and avoid substantial damage to the engines of their MMC vehicles. Therefore, such information is material product information.

PAR. 15. Respondent has at no time disclosed to owners of 1971-1980 model year MMC vehicles, through its owner's manuals or service manuals for MMC vehicles or otherwise, either brands and part numbers or replacement oil filters which would not substantially impair the reliability, durability, or performance of MMC vehicles or the fact that failure to use such filters on MMC vehicles could substantially impair the reliability, durability, or performance of such vehicles. Therefore, Chrysler's failure to disclose this material product information is deceptive or unfair.

PAR. 16. In the course and conduct of its business, and at all times mentioned herein, respondent has been, and is now, in substantial competition in or affecting commerce with corporations, firms, and individuals engaged in the sale of merchandise of the same general kind and nature as merchandise sold by respondent.

PAR. 17. The acts and practices of respondent, as herein alleged, were and are all to the prejudice and injury of the public and of respondent's competitors, and constituted, and now constitute, unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended. The acts and practices of respondent, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it has reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Chrysler Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 12000 Lynn Townsend Drive, in the City of Highland Park, State of Michigan.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For purposes of this order, the following definitions shall apply:

1. *Vehicle* shall mean any automobile, pickup truck, van, or recreational vehicle.

2. *MMC vehicle* shall mean any vehicle manufactured or assembled by or for Mitsubishi Motor Corporation of Japan, or any

subsidiary thereof, and sold by Chrysler Corporation in the United States, but shall not mean any vehicle model presently being manufactured by Chrysler in the United States or Canada or any successor to such model.

3. *Material Standard* shall mean any document, excluding drawings, which specifies, in whole or in part, performance or material requirements to be used in the design of a particular part for a vehicle.

4. *Dealer* shall mean any individual or other entity in the United States with which Chrysler Corporation has a Direct Dealer Agreement or an agreement of another name which is substantially similar to a Direct Dealer Agreement in nature.

5. *Owner* shall mean any individual or other entity in whose name a vehicle is currently or has been previously registered or titled with the appropriate state authority, including, but not limited to, vehicles held for resale.

6. *Current owner* shall mean any owner in whose name a vehicle is currently registered or titled with the appropriate state authority according to information provided respondent by a commercial locator service engaged by respondent pursuant to the provisions of Part IX of this order.

7. *Original owner* shall mean any individual or other entity to whom respondent's records show the original sale of the vehicle from a Chrysler Corporation dealer.

8. *Purchaser* shall mean any individual or other entity to whom a vehicle is sold on or after the first date any particular notice is disseminated by respondent pursuant to the provisions of this order to any current or original owner.

Part I

It is ordered, That respondent Chrysler Corporation, a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or indirectly or through any corporation, subsidiary, division, or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of any vehicle or vehicle part, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from representing, directly or by implication, in any Chrysler material standard for oil filters, that an oil filter which meets a hydrostatic burst strength requirement of 200 pounds per square inch will or may be capable of withstanding any oil pressure generated in the lubricating system of any MMC or Omni/Horizon

vehicle under any operating condition, assuming no malfunction of the lubricating system unless, at the time of making such representation, respondent possesses and relies upon competent and reliable engineering evidence which substantiates the truthfulness of such representation.

Part II

It is further ordered, That respondent Chrysler Corporation, a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or indirectly or through any corporation, subsidiary, division, or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of any vehicle or vehicle part, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

A. representing, directly or by implication, that any of respondent's material standards apply to every vehicle sold by respondent unless, at the time of making such representation, respondent possesses and relies upon a reasonable basis, consisting of competent and reliable engineering evidence, which substantiates such representation.

B. failing to disclose clearly and conspicuously in any of respondent's material standards, in those cases where such standard does not apply in all respects to every vehicle sold by respondent, that such standard is limited in its applicability.

C. representing, directly or by implication in any of respondent's material standards, any performance or material requirement for any replacement part to which such standard applies unless, at the time of making such representation, respondent possesses and relies upon a reasonable basis, consisting of competent and reliable engineering evidence, which substantiates such representation.

D. failing to disclose clearly and conspicuously in writing to each person to whom respondent provides any material standard(s), at the same time such standard is provided to such person, that (i) material standards are subject to constant revision, and (ii) respondent's Engineering Standards and Product Information Office, or the then current equivalent office by name, is in possession of the most current versions of all material standards, and (iii) respondent offers, at reasonable cost, a subscription service to its material standards through its Engineering Standards and Product Information Office, or the then equivalent office by name, which will automatically provide any subscriber with the most current version of any material

standard subscribed to, and (iv) non-subscribers should make sure they have the most current version of any particular material standard.

Part III

It is further ordered, That respondent Chrysler Corporation, a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or indirectly or through any corporation, subsidiary, division, or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of any vehicle or vehicle part, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, shall:

A. 1. offer at reasonable cost a subscription service to its material standards to any individual or other entity that pays the required annual subscription fee.

2. allow subscription at reasonable cost to any particular subject category, or other grouping of related material standards, or to all of its material standards depending on the subscriber's choice.

3. supply promptly to each subscriber the most current version of any particular material standard to which that subscriber has subscribed at the time such version first becomes available.

B. no later than thirty (30) days after this order is served upon respondent, purchase to be placed in six (6) consecutive issues of *Automotive News* which contain the service management section of that publication, beginning as soon as space becomes available, a black and white display advertisement, no smaller than three (3) columns by six (6) inches in size which effectively communicates the following information: (i) respondent's material standards for parts are available to any individual or company at reasonable cost through a subscription service; and (ii) the subscription service allows the subscriber to choose whether to receive part or all of respondent's material standards; and (iii) the subscription service will automatically provide most current versions of all material standards subscribed to; and (iv) more information about the subscription service may be obtained by contacting respondent's Engineering Standards and Product Information Office, or the then equivalent office by name.

Part IV

It is further ordered, That respondent Chrysler Corporation, a

corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of any MMC vehicle, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from representing, directly or by implication, in any post-purchase written communication to any owner or purchaser of any MMC vehicle, including, but not limited to, any communication in owner's manuals or service manuals, that any replacement part recommended for use in such vehicles will not or may not substantially impair the reliability, durability, or performance of such vehicle unless, at the time of making such representation, respondent possesses and relies upon a reasonable basis, consisting of competent and reliable engineering evidence, which substantiates such representation.

Part V

It is further ordered, That respondent Chrysler Corporation, a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or indirectly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, offering for sale, sale, or distribution of any MMC vehicle, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, shall:

A. once it ascertains, or should have ascertained, had it used due care, that use and care information supplied in writing to owners of any MMC vehicle or part thereof, if followed, could substantially impair the reliability, durability or performance of such vehicle, provide within sixty (60) days revised or additional information to:

a) each current owner, where the information pertains to any model year prior to the then current model year MMC vehicle; and

b) each original owner, where the information pertains to the then current model year MMC vehicle; and

c) each purchaser, where the information pertains to unsold MMC vehicles.

This revised or additional information shall clearly explain, in a conspicuous and easily readable format, the cause and nature of the problem and clearly state what steps, if known, can be taken to avoid it. This information shall be provided by letter or postcard where

current and/or original owners are to be notified. This information shall be provided at the time of sale by an insertion placed into the owner's manual which accompanies any affected unsold vehicle, where purchasers are to be notified.

B. accurately maintain the following records which may be inspected by Commission staff members upon fifteen (15) day's notice: all communications from any source concerning substantial impairment of vehicle reliability, durability or performance which (1) specifically refer to possibly erroneous use and care information or (2) respondent should reasonably understand from the content of the communication relate to possibly erroneous use and care information covered by Part V.A. of this order. Such records shall include, but not be limited to (a) all written communications; and (b) all oral communications which are reduced to writing and maintained in the ordinary course of business.

For purposes of this part of the order, *use and care information* shall mean any information disseminated by respondent regarding routine and periodic maintenance or servicing of a MMC vehicle, including, but not limited to, information disseminated in owner's manuals or service manuals.

Part VI

It is further ordered, That:

A. respondent shall send to each oil filter manufacturer whose name and address is listed on Exhibit A, a copy of the letter marked Exhibit B and a copy of Chrysler Specification MS 2999 within thirty (30) days after service of this order.

B. respondent shall send to each of its dealers, via respondent's normal service bulletin routing procedure, a copy of the Technical Service Bulletin marked Exhibit C and a copy of the Parts Marketing Bulletin marked Exhibit D within thirty (30) days after service of this order.

C. respondent shall send to each of its aftermarket parts wholesalers a copy of the Technical Service Bulletin marked Exhibit C and a copy of the Wholesaler Bulletin marked Exhibit E within thirty (30) days after service of this order.

D. respondent shall send to each of its warehouse distributors a copy of the Technical Service Bulletin marked Exhibit C and a copy of the Warehouse Distributor Bulletin marked Exhibit F within thirty (30) days after service of this order.

E. respondent shall send on a 4 ¼″ x 5 ¼″ postcard to each current owner of any 1971-1980 model year MMC vehicle with a

1600 cubic centimeter engine and to each current owner of any 1974-1980 MMC vehicle with a 2000 cubic centimeter engine a copy of Exhibit G within sixty (60) days after service of this order.

F. Respondent shall, beginning in the 1982 model year, effectively communicate the following information in a clear and conspicuous manner in its owner's manuals that accompany MMC vehicles with 1600 or 2000 cubic centimeter engines:

(1) that serious engine damage may occur because of oil filter failure, unless they use an oil filter that is strong enough to withstand engine oil pressures of at least 256 pounds per square inch; and

(2) the brand name and part number of at least one replacement oil filter which is adequate for use on such vehicle.

Provided, however, respondent shall no longer be required to make the disclosure set forth in Part VI.F. of this order if respondent can show, to the satisfaction of the staff of the Federal Trade Commission, that peak oil pressures typically generated by the engine of such MMC vehicle at start under cold ambient conditions do not significantly exceed peak oil pressures typically generated by the engines of respondent's domestic vehicles at start under cold ambient conditions.

For the purpose of Part VI.F. of this order, *domestic vehicle* shall mean any vehicle in which the engine is manufactured by Chrysler Corporation, as of the date this Agreement Containing Consent Order to Cease and Desist is signed by respondent.

Part VII

It is further ordered, That respondent shall accurately maintain the following records which may be inspected by Commission staff members upon fifteen (15) days' notice:

A. A list containing the name and address of:

1) each oil filter manufacturer to whom Exhibit B and a copy of Chrysler Specification MS 2999 was sent and the date such exhibit and Chrysler Specification MS 2999 were sent to each;

2) each dealer to whom Exhibit C and Exhibit D was sent and the date such bulletins were sent to each;

3) each aftermarket parts wholesaler to whom Exhibit C and Exhibit E was sent and the date such exhibits were sent to each;

4) each warehouse distributor to whom Exhibit C and Exhibit F was sent and the date such bulletins were sent to each;

5) each current owner of an MMC vehicle to whom Exhibit G was sent and a list with the date such exhibit was sent to each;

B. All communications received by respondent after the date this order is served on respondent from any source concerning a failed oil filter on any MMC vehicle. Such documents shall include, but not be limited to (a) all written communications; and (b) all oral communications which are reduced to writing and maintained in the ordinary course of business.

C. All records referred to in Part VIII shall be retained by respondent for a period of three (3) years from the last date appearing on any list referred to in this part of the order.

Part VIII

It is further ordered, That all correspondence required by the provisions of this order shall be sent, via first class mail. All correspondence to be sent in a letter shall be on respondent's corporate stationery. All envelopes, and where postcards are permitted to be used, the front side of the postcard, shall contain no marking other than respondent's name and return address, the name and address of the addressee, and the words "IMPORTANT NOTICE" conspicuously disclosed.

Part IX

It is further ordered, That respondent shall engage a commercial locator service, as required to be in compliance with the provisions of this order, to search, in the same manner that it conducts similar such search requests, all vehicle registration and title lists in the United States for the name and address of each individual or other entity in whose name any affected MMC vehicle is registered.

Part X

It is further ordered, That no provision of this order shall be construed to limit, in any way, any private right of action which any individual, partnership, corporation or other entity might have against respondent or against any other party.

Part XI

It is further ordered, That the respondent shall forthwith distribute a copy of this order to each of its operating divisions, to its successors and assigns, and to each of its officers, agents, representa-

tives, or employees who are supervisors of any department engaged in the engineering of any vehicle or vehicle part sold by respondent.

Part XII

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to the effective date of any proposed change in the respondent such as dissolution, assignment, or sale, resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of the order.

Part XIII

It is further ordered, That respondent shall within sixty (60) days after service upon it of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it intends to comply with this order. Respondent shall also within one hundred eighty (180) days after service upon it of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this order.

Separate Statement of Commissioner Pertschuk

The consumer comments received strongly criticized the Commission's decision not to seek redress for Chrysler owners who have suffered millions of dollars in damages due to balancer chain failures in certain Chrysler imports. These comments only strengthen my previously expressed feeling that this decision is not in the best interests of consumers. They vividly express my dismay with the fact that the Commission, despite getting a helping hand from Chrysler, did not walk the full mile to protect consumers in this instance.

Exhibit A

Oil Filter Manufacturers

AC Spark Plug Division
General Motors Corporation
1300 North Dort Highway
Flint, MI 48556

J.A. Baldwin Manufacturing Company
Kearney, NE 68847

Champion Laboratories, Inc.
P.O. Box 307
West Salem, IL 62476

FDI, Inc.
18451 Euclid Avenue
Cleveland, OH 44112

Ford Motor Company
Ford Parts & Services Division
P.O. Box 1902
3000 Schaefer Road, Room 308
Dearborn, MI 48121

Hastings Manufacturing Company
325 North Hanover Street
Hastings, MI 49058

Ohio Filter Company
2658 Airport Road
Bethel, OH 45106

STP Corporation
1400 West Commercial Boulevard
Fort Lauderdale, FL 33310

Aero-Mobile Systems, Inc.
200 Elm Street
Battle Creek, MI 49017

Campbell Filter Company
P.O. Box 880
Tulsa, OK 74101

Deluxe Filter Company
Walker Manufacturing Co.
1201 Michigan Boulevard
Racine, WI 53402

Fleetguard, Inc.
A Cummins Company
1340 River Bend Drive
Dallas, TX 75247

Fram Corporation
Fram Automotive Division
105 Pawtucket Avenue
Providence, RI 02916

Hutchens Industries, Inc.
2730 Melby Street
P.O. Box 184
Eau Claire, WI 54701

Purolator Products, Inc.
970 New Brunswick Avenue
Rahway, NJ 07065

Wix Corporation
P.O. Box 1967
Gastonia, NC 28052

CHRYSLER CORPORATION

Exhibit B

Sirs:

Enclosed please find Chrysler Specification MS 2999 which pertains to oil filters manufactured for use on certain Chrysler rear wheel drive vehicles. Please also be advised that MS 2999 does not apply to oil filters made for application on the Dodge Omni and Plymouth Horizon as well as on all Mitsubishi vehicles sold by Chrysler (Plymouth Arrow, Plymouth Arrow Pickup Truck, Plymouth Sapporo, Plymouth Champ, Dodge Colt, Dodge Colt Hatchback, Dodge Challenger, Dodge D-50 Pickup Truck). One of the reasons it does not apply to such vehicles is because such vehicles develop significantly higher oil pressures than most of Chrysler's domestic vehicles.

The oil filters manufactured for application on Omni/Horizon vehicles with a 1.7 liter engine should be able to withstand an internal hydraulic pressure of at least 290 psi while those manufactured for application on Mitsubishi vehicles should be able to withstand an internal hydraulic pressure of at least 256 psi. Of course, just because an oil filter meets a pressure standard does not make it proper for use on a vehicle unless the filter meets all the construction and dimensional requirements for the vehicle.

You should also be advised that owners of certain Mitsubishi vehicles are being notified by Chrysler Corporation that they should purchase oil filters for their vehicles which will withstand internal hydraulic pressures of 256 psi and should look for labels on the oil filter package and tell them this. Since oil filter boxes do not ordinarily provide this information to consumers, we would suggest specifically labeling the box of any oil filter recommended for use on these vehicles which meets the above pressure standard with a statement that the filter can withstand 256 psi.

Chrysler Corporation
Engineering Standards
and Product Information
Office

Enclosure

P. O. BOX 1118, DETROIT, MICHIGAN 48288

CHRYSLER CORPORATION MATERIAL STANDARD CHANGE - G
ASL Reg'd.

OIL FILTER - ENGINE LUBRICATING - FULL FLOW

A - GENERAL

1 - This standard covers full flow filter elements, replaceable filter element assemblies, and removable cartridge filter assemblies. The flow in all filter element designs shall be from outside in.

2 - The filter assemblies shall function in such a manner to provide clean lubricant at the required flow to maintain the proper operation of the engine and to insure adequate life. These filters are recommended for engine operation up to a maximum temperature of 275°F.

B - MATERIALS

1 - The filter media shall not consist of any abrasives of any type, and shall be so secured that it cannot be discharged into the engine lubrication system. This test is described in section E-4 of this standard.

2 - The filter elements and/or assemblies shall not contain any materials that disintegrate, dissolve in engine lubricating oils and their water mixtures, or are detrimental to engine wear or operation. These tests shall be conducted in accordance with Material Standard MS-CP60.

3 - The filter media shall be compatible with engine oil additives. All filter assemblies and elements shall be tested in accordance with paragraph 4.3.3 of Military Specification MIL-F-20707, except that the flow rate will be 2.5 gpm, the volume of test oil shall be 6000 ml, and the oil shall be Military Specification MIL-L-2104A Qualification No. M-54. The lubricating oil shall retain not less than 90% of its original additive content.

* 4 - A filter element or filter assembly shall not show a pressure drop increase greater than 2.0 psi when tested using clean Military Specification MIL-L-15016 oil, symbol 3065, at 100°F. Hourly water additions of 6 ml shall be made to a sump containing 6000 ml of oil. A flow rate of 2.5 gpm shall be maintained for a period of 24 hours.

5 - Coatings such as paint or grit on metal housings or shells shall adhere satisfactorily and shall not be brittle, chip, or flake off, when in transit or when being handled in production.

(Continued)

* Denotes area of change from previous issue.

DATE	EFF. CODE	P C R NO.	CHANGE	RELEASES - CHANGES AND CANCELLATIONS
6-14-67	3/MC	70901-021	G	Standard updated
1-27-69	3/SC	30107-021X	F	Par. D-2, D-6, E-3 and E-6-g revised
3-26-49				Date Issued (Sept. 1969)

VOLUME

PAGE

NOTE: The above standards and/or specifications are for use in supplying orders of Chrysler Corporation or its subsidiaries. Suppliers should determine the currency of their copies prior to use. The risk of compliance with the current standards and/or specifications is on the suppliers. Distribution hereof to others, whether paid or free, is for information only.

Copies are available from the Engineering Standards and Data Department, Engineering Office.

ENGINEERING OFFICE

CHRYSLER CORPORATION MATERIAL STANDARD

C - WORKMANSHIP

1 - The inside surfaces and passages of all filters and/or assemblies shall be free from foreign materials such as dirt, scale, core sand, metal chips, slivers, etc.

2 - The adhesive used to secure the filter paper to the end caps shall be so adhered that the adhesive cannot be peeled from the end caps.

3 - All of the filter paper ends shall be adhered securely to the end cap adhesive. Physical removal of the paper shall cause tearing of the paper.

4 - The paper shall have no breaks or tears and shall have the pleat ends securely sealed either by a full length metal strip or by a cementing operation.

5 - Sealing gaskets which are part of a spin-on filter shall be fastened securely by mechanical means.

6 - Housings which are part of cartridge assemblies shall be securely fastened to the base by an acceptable double lock-seam. An assembly which has been dropped once on a concrete surface from a height of 2 feet on the lock-seam shall not leak air up to 100 psi.

7 - All welds shall show metal fusion. Distortion of welded parts shall cause tearing of the metal at the weld.

D - MECHANICAL AND HYDRAULIC STRENGTH

* 1 - The elements and/or assemblies shall be of a suitable design to withstand 100 hours on a vibration test fixture without failure, distortion or leakage. The test assemblies shall be filled with SAE 30 oil and tested under a pressure of 70 psi. The test fixture shall meet the following or equivalent conditions:

a - The horizontal mounting platform of the vibration fixture shall be of sufficent rigidity to transfer the desired motion to the filter mounting without deflection.

b - The filter assembly shall be tested vertically with the filter base located 3.38 inches above the mounting platform.

c - Direction of motion shall correspond to the lateral vibration of the engine.

d - The static length of travel from one extreme to the other shall not exceed a range of 0.030 inches to 0.035 inches. In no case shall the total dynamic amplitude of the platform exceed 0.065 inches.

(CONTINUED)

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ENGINEERING OFFICE

CHRYSLER CORPORATION MATERIAL STANDARD

D - MECHANICAL AND HYDRAULIC STRENGTH (Continued)

1 - e - The frequency shall vary from 500 cpm to 4000 cpm, and the cycle shall be repeated every 55 seconds while operating for 25% of the time at 4000 cpm.

2 - The sealed and spin-on filter assemblies shall withstand an internal hydraulic pressure of 200 psi for one minute without leakage. All assemblies including replaceable element designs shall withstand an internal air pressure of 100 psi for one minute without leakage or permanent deformation.

* 3 - The filter assemblies shall withstand a minimum of 60,000 pulse cycles without leakage or failure at a rate of 30 cpm when operated hydraulically through a pressure range of 0 psi to 70 psi. The test fluid shall be SAE 10 or equivalent.

4 - The filter elements shall withstand a differential pressure of 50 psi without damage, channeling or collapse of the end caps or center tubes. These tests shall be conducted using a high viscosity fluid such as SAE-140 at a temperature range of 90°F to 100°F. The elements shall be tested using essentially the same supports as in actual usage.

5 - The filter elements shall withstand a differential pressure of 50 psi as noted in paragraph D-4, after operation with Military Specification MIL-L-2104-A oil, Qualification No. M-54, at 240°F with a rated flow of 2.5 gpm for a period of 40 hours.

6 - The shells, covers, housings, etc. in an assembly shall be made from materials having adequate strength for proper installation without distortion or malfunctioning in production and service.

Spin-on filter assemblies shall withstand a minimum tightening torque of 75 ft-lbs without stripping the attaching threads or loosening of any part of the attaching assembly. The filter base gasket shall be lubricated with SAE 30 oil and tested on a Chrysler filter base.

Spin-on filter assemblies incorporating removal features shall withstand a minimum tightening torque of 65 ft-lbs using the recommended removal tool designed for the specific purpose.

E - PERFORMANCE

1 - All pressure differential valves included in assemblies shall meet the requirements specified on the individual prints. The pressure rise above the valve opening pressure shall not exceed 6 psi when tested using a 38 SUS mineral oil at a flow of 6 gpm. The valve leakage using the same fluid at 3.5 psi shall not exceed a rate of 400 ml per hour.

(Continued)

NOTE: The above standards and/or specifications are for use in supplying orders of Chrysler Corporation or its subsidiaries. Suppliers should determine the currency of their copies prior to use. The risk of compliance with the current standards and/or specifications is on the suppliers. Distribution hereof to others, whether sale or free, is for information only.

Copies are available from the Engineering Standards and Data Department, Engineering Office.

CHRYSLER CORPORATION MATERIAL STANDARD

E - PERFORMANCE (Continued)

2 - The filters shall be checked for pressure drop using a 110 SUS mineral oil at 160°F. At a flow of 2.5 gpm, the pressure drop shall not exceed 3 psi on assemblies and 2 psi on elements.

3 - Filter assemblies incorporating anti-drainback valves shall show a leakage rate not exceeding 20 ml/hr. using a 45 SUS mineral oil at room temperature with a head of two feet. The test sample shall be initially flow flushed at a rate of 2.5 gpm for one minute using the test fluid. The leakage between the threads of the filter base and adapter shall be blocked during this test. The test assembly shall be installed finger tight plus 1/2 turn.

The anti-drainback valve shall conform to the above test conditions after being operated with Military Specification MIL-L-2104-A oil, Qualification No. M-54, at 240°F with a rated flow of 2.5 gpm for a period of 40 hours.

4 - The filter assembly shall show media migration not exceeding 5 milligrams per filter. The test shall be conducted in accordance with Military Specification MIL-F-0020627-A (Ships) paragraphs 4.5.3 and 4.5.4, except that the fluid used shall be Military Specification MIL-L-2104A, Qualification No. M-54, at 180°F with a flow of 2.5 gpm.

5 - The filter assemblies shall function properly without restricting the flow of oil to the engine at -20°F. A total of ten cold starts shall be a satisfactory test. This test will be conducted in the Chrysler Engineering Office Cold Test Laboratory.

6 - The filter life and average efficiency test shall be made using the SAE Lube Oil Filter Performance Test TR-160. The conditions of the test are:

* a - The test oil shall be heavy duty, SAE 30, as specified by the Coordinating Research Council Specification No. RFO-3. The source for this oil is

Southwest Research Institute
8500 Culebra Road,
San Antonio, Texas 78206

b - Volume of oil in sump: 6000 ml.

c - The test temperature at the filter shall be 160°F ±5°F.

d - The test shall be conducted using a flow of 2.5 gpm.

e - Oil samples shall be taken at the end of every 10 hour period and also at the end of the test.

(Continued)

NOTE: The above standards and/or specifications are for use in supplying orders of Chrysler Corporation or its subsidiaries. Suppliers should determine the currency of their copies prior to use. The risk of compliance with the current standards and/or specifications is on the suppliers. Distribution hereof to others, whether paid or free, is for information only.

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200-36-0 15-571

ENGINEERING OFFICE MS-2999

CHRYSLER CORPORATION MATERIAL STANDARD

E - PERFORMANCE (Continued)

6 - f - The contaminant add rate shall be 2.5 grams of dry solids per hour. The contaminant SOFTC-2A (Standardized Oil Filter Test Contaminant-Synthetic) is obtainable from:

Baltimore Paint and Color Works
2325 Annapolis Avenue
Baltimore, Maryland

The laboratory number for this material is X-7682. It shall contain 22% solids and 78% Military Specification MIL-L-15016 Straight Mineral Oil, symbol 3065. The specified composition is:

(1) - Sixteen parts by weight of carbon black having an average size of 85 millimicrons.

(2) - Two parts by weight of ferric oxide, 95% by count of the particles in the range from 0 to 5 microns.

(3) - Four parts by weight of PV resin.
The particle sizes of this material are as follows:

100% to pass through a 30 mesh screen.
90% to pass through a 80 mesh screen.
60% to pass through a 200 mesh screen.

g - The limiting differential pressure, life and efficiency for the test shall be as listed below:

PART NO. OR EQUIV.	PRESSURE DIFFERENTIAL, PSI	LIFE HOURS, MIN.	MIN. AVERAGE EFFICIENCY %
1851658	8	30	75

* F - CONTROL

1 - Chrysler Engineering Office Mechanical Development Laboratory approval must be obtained on original production samples and samples made after Material, Process, or design changes.

2 - The filters covered by this standard shall be purchased only from sources which appear on the Chrysler Engineering Approved Source List. This information can be obtained from the Chrysler Corporation Purchasing Department.

3 - This standard refers to the following standard.

Material Standard MS-CP60

# # # # #

NOTE: The above standards and/or specifications are for use in supplying orders of Chrysler Corporation or its subsidiaries. Suppliers should determine the currency of their copies prior to use. The risk of compliance with the current standards and/or specifications is on the suppliers. Distribution hereof to others, whether paid or free, is for information only.

Copies are available from the Engineering Standards and Data Department, Engineering Office.

Exhibit C

Technical Service Bulletin

Service & Parts Division

Technical Information +
Professional Service =
Customer Satisfaction

SERVICE

Of Interest ☐ General Manager ☐ Sales Manager ☐ Service Manager ☐ Parts Manager ☐ Service Technicians

Some reported oil filter leakages have resulted in serious engine damage to MMC vehicles of various model years, caused by using inadequate aftermarket oil filters.

To avoid leakage and engine damage due to the use of improper filters, owners of these vehicles should use an oil filter which will withstand 256 pounds per square inch of oil pressure, such as the filters indicated below:

Model	Part No.
All MMC except Champ and Colt Hatchback models	MD 001445
Champ and Colt Hatchback models only	MD 030795

Note:

Issuance of the above cancels MoPar Oil Filter (L-42) #4026486 previously specified. See Parts Marketing #XX-XX-XX

Models

MMC Passenger Cars and Trucks

Subject

Oil Filter Usage

Index

Engine

Date:

XX-XX-XX

No.

XX-XX-XX

CHRYSLER CORPORATION

(THIS BULLETIN IS SUPPLIED AS TECHNICAL INFORMATION ONLY AND IS NOT AN AUTHORIZATION FOR REPAIRS) REPRINT OF THIS MATERIAL NOT AUTHORIZED UNLESS APPROVED.

CHRYSLER Dodge Plymouth Dodge Trucks

Mopar

Parts Marketing Bulletin

PARTS SALES AND SERVICE

Mopar

ATTENTION: [X] DEALER [X] SERVICE MANAGER [ ] INSERT INTO MARKETING PROGRAMS BINDER UNDER TAB _____

[X] SALES MANAGER [X] PARTS MANAGER NUMBER

SUBJECT: OIL FILTERS - #4026486 (L-42)

All Dealers are requested to examine their stock of oil filters.

Any (L-42) #4026486 Oil Filters that are in stock should be returned for credit via normal M.R.A. (Material Return Authorization) procedures.

The subject filters should not be used.

This bulletin will act as your authorization to return subject oil filters to your facing depot.

M. G. KELLY
Marketing Manager

THE NEW CHRYSLER CORPORATION

Wholesaler Bulletin

Mopar

No. xxxxxxxx
Date xxxxxx

SUBJECT: Oil Filters - #4026486 (L-42)

All Warehouse and Jobber Distributors are requested to examine their stock of oil filters.

Any (L-42) #4026486 Oil Filters that are in stock should be returned for credit via normal M.R.A. (Material Return Authorization) procedures.

The subject filters should <u>not</u> be used.

This bulletin will act as your authorization to return subject oil filters to the Indianapolis Depot.

M. G. KELLY
Marketing Manager

Warehouse Distributor Bulletin

Mopa

General Information

No.xxxxxxxx
Date xxxxxx

SUBJECT: Oil Filters - #4026486 (L-42)

All Warehouse and Jobber Distributors are requested to examine their stock of oil filters.

Any (L-42) #4026486 Oil Filters that are in stock should be returned for credit via normal M.R.A. (Material Return Authorization) procedures.

The subject filters should not be used.

This bulletin will act as your authorization to return subject oil filters to the Indianapolis Depot.

M. G. KELLY
Marketing Manager

EXHIBIT G

IMPORTANT MAINTENANCE INFORMATION

Dear Owner:
Our records show that you are the owner of a Dodge Colt, Dodge Challenger, Plymouth Arrow, Plymouth Sapporo, Plymouth Arrow Pickup, Dodge D-50 Pickup, Plymouth Champ or Dodge Colt Hatchback which has either a 1600 cc engine with a 1971-1980 model year designation or a 2000 cc engine with a 1974-1980 model year designation.

THE PROBLEM: WEAK FILTERS

Certain kinds of replacement oil filters may not be strong enough to withstand the pressure in your car's lubricating system, particularly in cold weather. Weak oil filters can cause serious engine damage. What happens to cause the damage is this: If an oil filter is too weak, it may suddenly spring a leak. If the filter leaks, the engine loses oil and does not get enough lubrication and *the engine may be very seriously damaged.*

WARNING: PROTECT YOUR ENGINE

It is strongly recommended that you buy a new replacement oil filter now. A replacement filter costs only a few dollars. You must use a brand of filter strong enough to withstand 256 pounds per square inch of oil pressure. (Look on the oil filter box for a label with this information.) Chrysler's Mopar Filters (Part Number MD001445 for all vehicles except Champ and Colt Hatchback, and Part Number MD030795 for Champ and Colt Hatchback vehicles) meet the needs of your vehicle. These filters can be bought at any Chrysler Corporation dealer or auto parts store carrying this brand.

REPLACE THE FILTER SOON

If your car has the wrong kind of replacement filter, you should not postpone buying a new filter.

If you are leasing your car to another person, please make sure the person leasing it from you sees this notice.

CHRYSLER CORPORATION

Please staple or tape this notice to your Owner's Manual.

CHRYSLER
CORPORATION

416-15-19
P. O. BOX 1919
DETROIT, MICHIGAN 48288 U.S.A.

IMPORTANT NOTICE

IN THE MATTER OF

GIFFORD-HILL-AMERICAN, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3085. Complaint, Feb. 23, 1982—Decision, Feb. 23, 1982

This consent order requires a Grand Prairie, Texas producer and seller of concrete pressure pipe and fittings, among other things, to timely divest the entire "Kansas City Plant" to a Commission-approved buyer, capable of maintaining the plant as a competitive entity. Additionally, for a five year period, the company is required to offer the acquirer of the divested plant the opportunity to purchase essential products and services which are not generally available. The order also prohibits the company from acquiring any concern engaged in the production of concrete pressure pipe without prior Commission approval for a period of ten years.

Appearances

For the Commission: *Jerry A. Philpott, Claudia R. Higgins, Martha H. Oppenheim* and *Franklin M. Lee.*

For the respondent: *Bertram Kantor, Wachtell, Lipton, Rosen & Katz,* New York City.

COMPLAINT

The Federal Trade Commission, having reason to believe that Gifford-Hill-American, Inc. ("GHA"), a corporation subject to the jurisdiction of the Commission, has acquired the assets of the Lock Joint Products Division ("Lock Joint") of Interpace Corporation ("Interpace"), a corporation subject to the jurisdiction of the Commission, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45, and that a proceeding in respect thereof would be in the public interest, hereby issues this complaint, pursuant to Section 11 of the Clayton Act, as amended, 15 U.S.C. 21, and Section 5(b) of the Federal Trade Commission Act, as amended, 15 U.S.C. 45(b), stating its charges as follows:

I. Definitions

1. For the purposes of this complaint the following definitions shall apply:

a. *Pressure pipe* means pipe designed to carry water under pressure.

b. *Large diameter pressure pipe* means pressure pipe of over 54 inches in diameter.

c. *Concrete pressure pipe* means pressure pipe that comports with American Water Works Association standards C300–74, C301–79, C302–74 and/or C303–78.

c. *South central region* means the states of Texas, New Mexico, Oklahoma, Arkansas, and Louisiana.

II. GHA

2. GHA is a corporation organized and existing under the laws of the State of Texas with its principal office at 1003 Meyers Road, Grand Prairie, Texas.

3. GHA is one of the leading manufacturers in the production and sale of concrete pressure pipe and fittings in the United States.

4. In 1980, GHA had total sales of $61,700,000 and total assets of $34,100,000.

5. GHA has four production facilities, all located in the State of Texas. These plants serve a marketing area including much of the south central region.

III. Interpace

6. Interpace is a corporation organized and existing under the laws of the State of Delaware, with its principal office at 260 Cherry Hill Road, Parsippany, New Jersey.

7. Interpace's concrete pipe manufacturing division, Lock Joint, produces and sells concrete pressure pipe and fittings.

8. In 1980, Lock Joint had net sales of approximately $96,800,000 and total assets of $53,400,000.

9. Lock Joint has plants located in Florida, Illinois, Kansas, Maryland, Ohio, New Jersey, South Carolina, and Puerto Rico.

IV. Jurisdiction

10. At all times relevant herein GHA and Interpace have been engaged in the production and sale of concrete pressure pipe in interstate commerce and GHA and Interpace are engaged in commerce as "commerce" is defined in the Clayton Act, as amended, 15 U.S.C. 12, *et seq.*, and each is a corporation whose business is in or affects commerce as "commerce" is defined in the Federal Trade Commission Act, as amended, 15 U.S.C. 41, *et seq.*

V. The Acquisition

11. On or about February 27, 1981, GHA and Interpace entered into an agreement in principle which provides, *inter alia,* for the acquisition by GHA of the non-Puerto Rican assets of Lock Joint. The acquisition was consummated on or about July 2, 1981.

VI. Trade and Commerce

12. The relevant lines of commerce are the manufacture and sale of pressure pipe, large diameter pressure pipe and concrete pressure pipe.

13. The relevant section of the country is the south central region.

VII. Actual Competition

14. Prior to the acquisition, GHA and Lock Joint were and had been for many years actual competitors in the manufacture and sale of pressure pipe, including large diameter pressure pipe and concrete pressure pipe, within the relevant section of the country.

VIII. Effects

15. The effects of the acquisition may be substantially to lessen competition or to tend to create a monopoly in the relevant markets in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and the acquisition constitutes an unfair method of competition and unfair act or practice within the meaning of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45, in the following ways, among others:

(a) actual competition between GHA and Lock Joint in the relevant markets may be eliminated;

(b) actual competition among competitors generally in the relevant markets may be lessened;

(c) concentration in the relevant markets may be increased and the possibilities for eventual deconcentration may be diminished;

(d) mergers or acquisitions between other pressure pipe producers in the relevant markets may be fostered, thus causing a further substantial lessening of competition or tendency toward monopoly in such markets; and

(e) barriers to entry into the relevant markets may be increased.

IX. Violations Charged

16. By reason of the foregoing, the acquisition by GHA of the assets of Lock Joint constitutes a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45.

Decision and Order

The Federal Trade Commission having initiated an investigation of the proposed acquisition of the Lock Joint Products Division of Interpace Corporation (hereinafter referred to as "Lock Joint") by Gifford-Hill-American (hereinafter referred to as "GHA"), and GHA having been furnished thereafter with a copy of a draft of complaint which the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge GHA with violations of the Federal Trade Commission Act and the Clayton Act; and

GHA, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by GHA of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by GHA that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that GHA has violated the said Acts, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comments filed thereafter by interested persons pursuant to Section 2.34 of its Rules, now in further conformity with the procedure described in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. GHA is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Texas with its offices and principal place of business located at 1003 Myers Road, in the city of Grand Prairie, State of Texas.

2. The Federal Trade Commission has jurisdiction of the subject

matter of this proceeding and of GHA, and the proceeding is in the public interest.

Order

For purposes of this order,

(a) *respondent* means Gifford-Hill-American, Inc., its subsidiaries, affiliates other than Ameron, Inc., and Gifford-Hill & Co., Inc., divisions, successors, and assigns;

(b) *Kansas City Plant* means the concrete pressure pipe facility located in Kansas City, Kansas, acquired by respondent from Interpace Corporation; and

(c) *Lock Joint Division* means the concrete pressure pipe production assets acquired by respondent from Interpace Corporation

I

It is ordered, That, within fifteen (15) months from the date on which this order becomes final and subject to the prior approval of the Federal Trade Commission, respondent shall divest absolutely and in good faith the entire Kansas City Plant as a viable business concern to a third party that represents that it intends to use the assets in the manufacture, distribution or sale of concrete pressure pipe in the United States. Pending divestiture, respondent shall neither make nor permit any deterioration of the Kansas City plant, except for normal wear and tear, that may impair its operating abilities, competitive viability or market value.

II

It is further ordered, That, at the option of the acquirer of the assets of the Kansas City Plant, respondent (including its newly acquired Lock Joint Division) shall for a period of five years from the date of the divestiture required by Paragraph I offer to sell to the acquirer at a commercially reasonable price all joint rings, prestressing wire, molds, and engineering and technical services that are not generally available and are essential to the manufacture of the concrete pressure pipe and related products to be produced by the Kansas City Plant. The price respondent shall charge the acquirer for any such joint ring, prestressing wire, mold or service shall be no less favorable than the price at which respondent makes comparable sales of that variety of product or service to any other concrete pressure pipe manufacturer. If respondent has no such sales to any

other concrete pressure pipe manufacturer, then the price shall be the prevailing market price for comparable sales of that variety of product or service.

III

It is further ordered, That, for a period of ten (10) years from the date this order becomes final, respondent shall not acquire, without the prior approval of the Federal Trade Commission, directly or indirectly, any stock interest in or assets of any concrete pressure pipe manufacturer in the United States.

IV

It is further ordered, That, within (60) days after the date this order becomes final, and every sixty (60) days thereafter until respondent has fully complied with the provisions of Paragraph I of this order, respondent shall submit to the Federal Trade Commission a verified written report setting forth in detail the manner and form in which it intends to comply, is complying with, or has complied with that provision. All compliance reports shall include, among other things that are required from time to time, a full description of contacts or negotiations with any party for the sale of properties specified in Paragraph I of this order, and the identity of all such parties. Respondent shall furnish to the Commission copies of all written communications to and from such parties, and all internal memoranda, reports, and recommendations concerning divestiture.

On the date of divestiture and on every anniversary date of the divestiture thereafter for the following five (5) years, respondent shall submit to the Commission a verified written report setting forth the manner and form in which it is complying or has complied with Paragraph II of this order.

On the first anniversary of the date this order becomes final and on every anniversary date thereafter for the following nine (9) years, respondent shall submit to the Commission a verified written report setting forth the manner and form in which it has complied or is complying with Paragraph III of this order.

V

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, or any other proposed change

in the corporation, which may affect compliance obligations arising out of this order.

IN THE MATTER OF

GROLIER, INCORPORATED, ET AL.

FINAL ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 8879. Complaint, March 9, 1972 —Final Order, March 9, 1982*

The FTC is reissuing its Final Order in Docket No. 8879, In the Matter of Grolier, Inc. On March 13, 1978, the Commission issued its Order to Cease and Desist (91 F.T.C. 315); modified December 10, 1981 (98 F.T.C. 882). The reissued order, effective March 9, 1982, among other things, requires a New York City publisher and seller of encyclopedias and other educational materials and services, and its subsidiaries, to cease misrepresenting, failing to make relevant disclosures, or using any other unfair or deceptive methods to recruit door-to-door sales personnel, sell merchandise and services, and collect debts.

FINAL ORDER

This matter having been heard by the Commission upon remand by the United States Court of Appeals for the Ninth Circuit, and the Commission having denied a motion to disqualify Judge von Brand after allowing Grolier discovery on the matter in an Order issued August 13, 1981, and the Commission, having made certain modifications to the original cease and desist order issued on March 13, 1978, in an Order issued December 10, 1981, now reissues its Final Order, with said modifications, as follows:

It is ordered, That the following Order to Cease and Desist be, and it hereby is, entered:

ORDER

I

It is ordered, That respondents Grolier, Incorporated, Americana Corporation, Grolier Interstate, Inc., Grolier New Era Corp., Madison Enterprises, Inc., R. H. Hinkley Company, The Grolier Society, Inc., Spencer International Press, Inc. and The Richards Company, Inc., corporations and their successors, assigns, officers, agents, representatives and employees, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the recruitment, training, or orientation of any person to sell, rent, lease, or distribute any textbook, encyclopedia, reference or educational material, training course or teaching machine, or any other

* Complaint, Initial Decision, Opinion of the Commission and Final Order previously published at 91 F.T.C. 315.

publication, merchandise or service, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Representing, directly or by implication, either orally or in writing, that:

(1) any respondent is offering positions in such fields as advertising, education, public relations, marketing, interviewing, or in any field other than door-to-door sales, if door-to-door sales is included, to any extent, in the position for which persons are being recruited; or misrepresenting, in any manner, the job for which any person is being solicited;

(2) persons will be trained as management trainees, or for other positions of responsibility concerned with administrative office functions, unless, in fact, a formal management training program is available to persons accepting employment on the basis of such representations; or misrepresenting, in any manner, the amount and type of training that will be given;

(3) any person who may be employed will contact prospects in their homes or places of business for the purposes of conducting surveys, advertising promotions, educational instruction or other nonselling functions; or misrepresenting, in any manner, the purposes for which any person is engaged.

B. Misrepresenting, in any manner, the amount of income to be earned by any person or that may be earned by any person, the method of payment, or any condition or limitation imposed upon the compensation of any person, or the degree of ease or difficulty in performing any said condition imposed.

C. Failing to disclose, clearly and conspicuously, in all advertising offering employment in any way involving door-to-door sales:

(1) that the respondent concerned is recruiting persons for the sole purpose of soliciting or selling;

(2) that such soliciting or selling will be on an "in home" basis;

(3) that the products or services being sold are encyclopedias or services to be used in connection therewith, or in the event that encyclopedias or such related services are not being sold, the products and services being sold; and

(4) the basis for compensating persons so engaged.

D. Failing to clearly and conspicuously advise, both orally and in writing, any prospective salesperson at the initial face-to-face

interview, and prior to executing any employment agreement with any such person, the following information:

(1) all those disclosures set forth in Paragraph I C above;

(2) a complete and detailed description of each condition and limitation imposed upon the receipt of any compensation;

(3) where applicable, notification that such person will not be paid for time spent during orientation and training;

(4) a complete and detailed description of any expense or expenses any such person may incur performing the required duties; and

(5) the percentage of persons holding similar positions engaged by the office offering the position during the twelve (12) months immediately preceding the offer, who have actually received an equivalent, or greater, income than that promised under the terms of any such agreement.

E. Failing to furnish to each applicant at the initial face-to-face interview and prior to executing any employment agreement with any such person, a copy of Paragraphs I, II and V of this Order together with a cover letter as set forth in Appendix A attached hereto.

F. Making, distributing or using any training tapes, sales manuals, or any other document, method or device which contains any representation or instruction inconsistent with any provision of Paragraph I or Paragraph II of the Order.

II

It is ordered, That respondents Grolier, Incorporated, American Corporation, Grolier Interstate, Inc., Grolier New Era Corp., Madison Enterprises, Inc., R. H. Hinkley Company, The Grolier Society, Inc., Spencer International Press, Inc., and The Richards Company, Inc., corporations and their successors, assigns, officers, agents, representatives, and employees, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the publishing, advertising, offering for sale, sale, rental, lease or distribution of any textbook, encyclopedia, reference or educational material, training course or teaching machine, or any other publication, merchandise or service, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Disseminating or causing to be disseminated any advertisement or promotional material which solicits participation in any

contest, drawing or sweepstakes, or solicits any response to any offer of merchandise, service or information, unless any such solicitation clearly and conspicuously discloses that a person who replies as requested may be contacted directly by a salesperson for the purpose of selling respondents' products, using one of the following disclosures:

1. IMPORTANT: This card will let you know of my interest and enable your [location designation, if appropriate] sales representative to

(contact me at home)		(information)
(call or visit me)	with	(details)
(contact me in person)		(facts)

on how I may (purchase) [applicable product].
(buy)

2. IMPORTANT: Returning this card allows me to have your [location designation, if appropriate] sales representative

(contact me at home)		(information)
(call or visit me)	with	(details)
(contact me in person)		(facts)

on how I may (purchase) [applicable product].
(buy)

3. IMPORTANT: Returning this card will enable your [location designation, if appropriate] sales representative to

(contact me at home)		(information)
(call or visit me)	with	(details)
(contact me in person)		(facts)

on how I may (purchase) [applicable product].
(buy)

Upon prior approval in writing of the Assistant Director of the Division of Compliance of the Bureau of Consumer Protection, or his designee, respondents may use any other disclosure that clearly and conspicuously discloses that a person who replies as requested may be contacted directly by a salesperson for the purpose of selling respondents' products. A request for approval shall be in writing and shall be deemed granted if not disapproved within 30 days after receipt by the Assistant Director of the Division of Compliance of the Bureau of Consumer Protection.

B. Providing any return card, coupon or other device which is used to respond to any advertisement or promotional material covered by Paragraph II(A) above, unless one of the disclosures set forth in such Paragraph, or a disclosure approved by the Assistant Director of the Division of compliance or his designee as satisfying

the requirements of Paragraph II(A), clearly and conspicuously appears in immediate proximity to the space provided for a signature or other identification of the responding party. During the one (1) year period from the date this Order becomes final, respondents may submit a request to reopen these proceedings pursuant to Section 2.51 of the Commission's Rules of Practice. Such petition shall contain information demonstrating that any proposed modifications of Paragraphs II(A) and II(B) will clearly and conspicuously disclose to potential purchasers of respondents' products that a person who replies as requested may be contacted directly by a salesperson for the purpose of selling respondents' products. The foregoing sentence shall not be construed as a limitation of respondents' submission of additional information regarding the request to reopen, including information relating to the financial impact of Paragraphs II(A) and II(B) on respondents. Should a request be submitted, the Commission shall determine whether to reopen these proceedings within one hundred-twenty (120) days of receipt of such request. The procedure to reopen the proceedings as set forth herein is in addition to, and not in lieu of, any other procedure (or time period with respect to such procedure) permitted by law or the Commission's Rules of Practice.

C. Failing to disclose clearly and conspicuously, at the beginning of any telephone call to any prospective customer, the fact that the individual making the call is either soliciting the sale, rental or lease of publications, merchandise or services for respondents, or is arranging for a sales solicitation to be made, and that if the prospective customer so agrees, the respondent concerned will send a salesperson to visit said prospect for the purpose of soliciting the sale, rental or lease of said publications, merchandise or services.

D. Visiting the home or place of business of any person for the purpose of soliciting the sale, rental or lease of any publications, merchandise or service, unless at the time admission is sought into the home or place of business of such person, a card 3 inches by 5 inches in dimension, with all words in 10-point bold-face type, with the following information, and none other, in the indicated order, is presented to such person:

(1) the name of the corporation;

(2) the name of the salesperson;

(3) the term "Encyclopedia Sales Representative" [or other applicable product];

(4) the terminology: "The purpose of this representative's call is to solicit the sale of encyclopedias" [or other applicable product].

Provided, however, That for one (1) year from the date this order becomes final, respondents may, in lieu of the card required by this Paragraph of the Order, substitute a business card of at least 2 inches by 3–½ inches containing only the following information:

1. the name of the corporation
2. the name of the salesperson
3. the term "sales representative"
4. An address and telephone number at which the corporation or salesperson may be contacted
5. the product or the corporation logo or identifying mark.

During this one (1) year period, respondents shall comply in all other respects with the requirements of Paragraph II(D) above. Prior to the expiration of the aforesaid time period, respondents may submit a request to reopen these proceedings pursuant to Section 2.51 of the Commission's Rules of Practice. Such petition shall contain information demonstrating that the business card required in Paragraph II(D), as modified above, is effective in communicating to potential purchasers, prior to the entry into their homes or places of business by any of respondents' sales representatives, that the purpose of the sales representatives' call is to solicit the sale of respondents' products. The foregoing sentence shall not be construed as a limitation on respondents' submission of additional information regarding the request to reopen, including information on the financial impact of Paragraph II(D) on respondents. Should a request be submitted, the Commission shall determine whether to reopen these proceedings within one hundred-twenty (120) days of receipt of such request. Respondents may continue to use the business card, as described by this proviso, during the time that a request to reopen these proceedings pursuant to this Paragraph is pending, and, if such proceedings are reopened, until the Commission determination of the matter has become final. The procedure to reopen the proceedings as set forth herein is in addition to, and not in lieu of, any other procedure (or time period with respect to such procedure) permitted by law or the Commission's Rules of Practice.

E. Failing to give the card, required by Paragraph II(D), above, to each person and to provide each such person with an adequate opportunity to read the card before engaging any such person in any sales solicitation.

F. Using the words "Mothers Club" or words of similar import and meaning to represent, directly or by implication, the existence of a *bona fide* educational program, club, or business entity which provides educational services or benefits to consumers or using any

trade name misrepresenting in any manner the nature or purpose of their business.

G. Representing, directly or by implication, either orally or in writing that:

(1) Any person calling on any prospective purchaser is:

(a) engaged in or connected with "advertising", "marketing", "promotion", "education", or anything other than the sale of encyclopedias or other educational or reference materials;

(b) conducting, taking or participating in a survey, opinion poll, interview or any other information gathering activity; or

(c) calling on said prospect for the primary purpose of delivering or disseminating any vacation gift certificate, prize, gift, gift certificate, chance in any contest, or any other merchandise or item of chance;

(2) only a few minutes will be required to complete the visit inside the prospective purchaser's home or place of business; or misrepresenting, in any manner, the period of time required to complete the sales or other presentation;

(3) any person contacted has been specially selected to receive any offer; or misrepresenting, in any manner, the persons or class of persons to whom said offer is available;

(4) any encyclopedia or other reference material is a new publication, or a publication which has not been previously available to the public unless such is the fact, or misrepresenting, in any manner, the extent of editorial revisions, in any encyclopedia or other reference material;

(5) any offer is limited, must be accepted immediately or within a specified time period, or is a special offer, unless such is a fact; or misrepresenting, in any manner, the nature, scope or duration of any sales offer;

(6) any publication, merchandise or service is being offered free, without cost, as a bonus, reduced in price or otherwise to any prospective purchaser of any of respondents' publications, merchandise or services agreeing to perform any advertising promotional or selling function, including but not limited to, any of the following acts or similar acts:

(a) permitting their names to be listed as local owners of the product or services;

(b) providing the name of any person who may be interested in purchasing any publication, merchandise or service;

(c) writing a letter evaluating the merits of any publication or other item which may be used in advertising;

(d) displaying any publication or other item in a conspicuous location in his home;

(e) keeping any publication or other item current by purchasing an annual yearbook or by purchasing any research service;

(f) completing installment payments for any item in a period of time less than the period of time initially represented; or

(g) paying a membership fee in order to participate in the Consumer Buying Educational Service, or any other program, club, service or entity which provides an opportunity for participants to purchase merchandise at a savings from the the retail prices for such merchandise, or paying a fee to participate in any similar program, club, service or entity; or

(h) misrepresenting, in any manner, that any publication, merchandise or service is being offered free, without cost, as a bonus, or reduced in price to any person;

(7) any publication, merchandise or service is being offered free, without cost, or is given as a bonus or otherwise to any purchaser of any of respondents' publications, merchandise or services, pursuant to any agreement to purchase, rent or lease any other publication, merchandise, or service, or combination thereof, from such respondent, unless:

(a) the contract price for the purchase, rental or lease of any such other publication, merchandise, service, or combination thereof, has remained at the said price or above for at least six (6) months within the last twelve (12) months immediately preceding the time at which the representation is made;

(b) no publication, merchandise or service has been offered free, without cost or given as a bonus or otherwise with the sale, rental or lease of any such other publication, merchandise, service or combination thereof, to any person for a period of at least six (6) months within the last twelve (12) months immediately proceding the time at which the representation is made;

(c) no publication, merchandise, service, or combination thereof, of equivalent or greater value, has been eliminated by such respondent from any such other publication, merchandise, service, or combination thereof, with which the free, without cost or bonus publication, merchandise or service is being offered;

Provided however, any such prices as are restricted by Paragraph II

G (7)(a) of this Order may be altered at any time by the respondent concerned to reflect *bona fide* changes in market conditions.

H. Misrepresenting, in any manner, the terms, conditions, method, rate or time of payment actually made available to any person.

I. Representing, directly or by implication, either orally or in writing that:

(a) any person using any research service will receive answers to questions on any subject; or misrepresenting, in any manner, the scope of, or restrictions imposed upon the use of, any such research service;

(b) any answer provided by a research service is the product of detailed, exhaustive or original research generated by the specific question asked by any person utilizing said service unless such is the fact; or misrepresenting, in any manner, the extent of individual attention, research, preparation or quality of any answer furnished by any such research service;

(c) any answer provided by any research service is a suitable or acceptable substitute for any term paper, theme or other report; or misrepresenting, in any manner, the benefit or use of any answer provided by any research service;

(d) any research service is being offered at any price or that the research service has a retail value unless such is the fact;

(e) the cost to any respondent of any research service represents a retail value.

J. (1) Failing to disclose, clearly and conspicuously, in writing on all promotional materials describing any research service, and orally during the course of any sales or other presentation relating to said service, each condition or limitation placed upon the use of such research service.

(2) Failing to disclose applicable limitations on the time within which answers will be supplied by any research service in writing on all promotional materials and orally during the course of any sales presentations relating thereto.

K. (1) Representing, directly or by implication, through the use of any oral statement, written quotation, picture or any other means that any publication, merchandise or service has received an endorsement, recommendation, or sponsorship from any educational, religious, or other institution or other entity or from any person, unless the stated endorsement is genuine and authentic in all respects, and discloses the year or edition of the publication to which such endorsements pertain, if a publication is involved.

(2) Using, publishing, or referring to any testimonial or endorsement unless (1) such use, publication, or reference is expressly authorized in writing and unless (2) respondents have good reason to believe that at the time of such use, publication, or reference, the person or organization named subscribes to the facts and opinions therein contained.

(3) Representing, in any manner, that an endorsement or testimonial has been recently executed or is current unless this is the fact.

(4) Misrepresenting, in any manner, that any person is calling on a prospective customer with the endorsement, recommendation, or sponsorship of another person or organization.

L. Failing to disclose:

(1) clearly to the officials of any educational institution being visited, where a purpose of such visit is to obtain the institution's permission to disseminate through the institution promotional material which solicits the sale of any product to the parents of the children enrolled in the educational institution, and which is designed to secure leads for in-home sales presentations, prior to any such dissemination, that the purpose of disseminating such promotional materials is to secure leads for in-home sales presentations;

(2) conspicuously on the face of such promotional materials within the scope of L(1) that dissemination of such promotional materials through the educational institution does not constitute an endorsement or a recommendation by the institution or its officials that such materials being promoted should be purchased unless such is the fact.

M. Representing to any person, directly or by implication, either orally or in writing that:

(1) any price is the retail, regular, usual or words of similar import or effect, price for any publication in any binding, merchandise or service, unless the respondent concerned is making a substantial number of its unit sales for each such publication in each such binding, merchandise or service, individually, at or above the represented price;

(2) any price is the retail, regular, usual, or words of similar import or effect, price for any set of publications in any binding and in combination with any other publication, merchandise or service, unless the respondent concerned is making a substantial number of its unit sales for each such set of publications in each such binding individually or in combination at or above the represented price;

(3) savings may be realized by the purchase, rental or lease of any publication, merchandise or service, or any combination thereof, from any of respondents' former prices for its products unless:

(a) such savings claims are based upon retail, regular, or usual prices, or combination prices, arrived at in accordance with Paragraph II M(1) and (2) above;

(b) respondents clearly and conspicuously specify the publication, merchandise or service, or combination thereof, and the price from which the savings are to be realized; and

(c) the publication, merchandise or service is of comparable quality in all material respects with the publication, merchandise or service sold at the higher price;

(4) savings may be realized by the purchase, rental or lease of any publication, merchandise or service, or any combination thereof, from comparable products of competitors unless:

(a) the respondent concerned clearly and conspicuously specifies the publication, merchandise or service, or combination thereof, from which the savings are to be realized;

(b) the price utilized for comparison purposes is the price at which a substantial number of persons have purchased the item referred to in (a) immediately above;

(c) the item referred to in (a) above is of comparable quality in all material respects to the product being sold;

(d) respondents have in good faith conducted a market survey or obtained a similar representative sample of prices in the trade area where the comparison is made which establishes the validity of said compared price.

N. Misrepresenting in any manner, either orally or in writing:

(1) the amount of savings to be realized by any person who enters into an agreement with any respondent for any publication, merchandise or service; or

(2) that any publication, merchandise or service is being offered free or without charge, or is given to any such person.

O. Failing to comply with any and all provisions of the Commission's Trade Regulation Rule, *Cooling-Off Period For Door-To-Door Sales* (16 C.F.R. 429.1), which are in effect on the date this Order becomes effective, and with any modifications or changes in the aforesaid Rule which may be made. A copy of the said Rule shall be

made a part of this Order for purposes of complying with other provisions hereof.

P. Initiating contact with any purchaser through any means for any reason from the time said purchaser enters into any agreement containing a NOTICE OF CANCELLATION, as required by Paragraph II O of this Order, until said buyer's cancellation period has expired.

Q. Failing to maintain a copy of each NOTICE OF CANCELLATION received pursuant to Paragraph II O of this Order, and making said documents available for inspection and copying by the Commission's staff upon reasonable notice. Any respondent receiving such NOTICE shall maintain it for a period of three (3) years from date of receipt.

R. Failing to create adequate records, which shall be maintained for a period of three (3) years and made available to the Commission's staff for inspection and copying upon reasonable notice, from which the validity of any savings claims, retail price claims, comparative value claims, or other representations of the type described in Paragraphs II G(7), II M and II N of this Order can be determined, and making any pricing claims within the scope of this provision unless there are in existence for at least the six (6) months preceding such claims records from which the validity of such claims can be determined.

S. Failing to attach to any contract for the sale, rental or lease of any publication, merchandise, service or combination thereof a written statement that clearly and conspicuously discloses, and only discloses, the following information in the indicated order and manner:

(1) in 12-point bold-face type size the terminology:

PRICE LIST

THE FOLLOWING PRICES ARE THE *ONLY* AUTHORIZED PRICES AT WHICH THE LISTED ITEMS MAY BE OFFERED.
ANY PRICE NOT LISTED BELOW IS UNAUTHORIZED AND FALSE.

(2) a list of all publications, merchandise, services or combination thereof currently offered for sale, rental or lease, and in immediate conjunction thereto each price at which any respondent is authorized to offer said product or service pursuant to Paragraph II M of this Order.

(3) in 12-point bold-face type the terminology, when applicable:

FREE ITEMS

ONLY THE FOLLOWING PRODUCTS AND SERVICES MAY BE OFFERED FREE. YOU ARE PAYING FOR ANY ITEMS RECEIVED AND NOT LISTED BELOW.

(4) a list of all publications, merchandise or services currently offered as free, without cost, or as a bonus pursuant to Paragraph II G(7) of this Order.

T. Failing to orally instruct any person at the time said person signs any contract for sale, rental or lease, of any publication, merchandise, service or combination thereof, pursuant to an oral sales presentation, that a "Price List" is attached to said person's contract.

III

It is further ordered, That respondents Grolier, Incorporated, American Peoples Press, Inc., Americana Interstate Corp., Career Institute, Inc., Grolier Enterprises, Inc., and Grolier Reading Programs, Inc., corporations, and their successors or assigns, their officers, agents, representatives and employees, directly or indirectly, through any corporation, subsidiary or division, or other device, in connection with the advertising, offering for sale, sale or distribution of any textbook, encyclopedia, reference or educational material, training course or teaching machine, or any other publication, merchandise or service through the use of any program, plan, method or device, that provides or purports to provide for the sale or distribution of any of said items to any person on an approval basis, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Representing, directly or by implication, either orally or in writing that:

(1) any person has the option to receive each publication, merchandise or service, separately and individually, and to accept or reject same, unless such person is allowed in all instances to receive and to purchase or reject each such publication, merchandise or service separately and individually;

(2) any person will not receive any further publication, merchandise or service after the respondent concerned has received a timely notification of the person's cancellation of any such program, plan or method of sale or distribution, unless such is the fact; or misrepresenting, in any manner, any consequence resulting from any

person's cancellation of his participation in any such program, plan, or method of sale or distribution; and

(3) any person incurs no risk or obligation by joining or participating in any such program, plan, or method of sale or distribution; or misrepresenting, in any manner, any condition, right, duty or obligation imposed on any person.

B. Disseminating, or causing the dissemination of, any advertisement which fails to disclose in a clear and conspicuous manner:

(1) a description of the conditions and terms of any such program, plan, or method of sale or distribution, and the duties, risks and obligations of any subscriber thereto; and

(2) a description of each publication, merchandise or service to be offered for sale, the billing charge to be made therefor, the anticipated total number of publications, merchandise or services included in any such program, plan or method of sale or distribution, the number of publications, merchandise or services that will be included in each shipment of such items, and the number of and the intervals between each such shipment.

C. Failing to disclose, clearly and conspicuously, on any return coupon, order form or any other document used for responding to any such program, plan, or method of sale or distribution, the following information:

(1) the anticipated total number of publications, merchandise or services included in any such program, plan, or method of sale or distribution;

(2) the number of publications, merchandise or services that will be included in each shipment of such items; and

(3) the number of and the intervals between each such shipment.

D. Failing to disclose, clearly and conspicuously, in immediate conjunction with any publication, merchandise, service or notice thereof sent to any subscriber the anticipated date on which the respondent from whom the subscriber obtained any of such items will initiate processing of the next shipment of any such item.

E. Failing to provide to any person in conjunction with each notice of any shipment of any publication, merchandise or service, a clear and conspicuous means by which said person may exercise his option or right to cancel said shipment, if such is his right.

IV

It is further ordered, That respondents Grolier, Incorporated, American Peoples Press, Inc., Americana Corporation, Americana Interstate Corp., Federated Credit Corp., Career Institute, Inc., Grolier Interstate, Inc., Grolier New Era Corp., Madison Enterprises, Inc., R.H. Hinkley Company, Spencer International Press, Inc., The Grolier Society, Inc., and The Richards Company, corporations, and their successors, assigns, officers, agents, representatives and employees, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the collection or attempted collection of any debt allegedly due and owing pursuant to any contract or other agreement relating to the purchase or other receipt of any textbook, encyclopedia, reference or educational material, training course or teaching machine, or any other publication, merchandise or service, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Representing, directly or by implication, either orally or in writing that:

(1) any company, corporation, or entity engaged in collection of monies allegedly due or owing to such concerns or any other company, corporation or entity has separate *bona fide* departments or divisions for legal matters, unless such are the facts; or misrepresenting, in any manner, the existence, or functions of any division or department of any company, corporation or entity;

(2) the Code of Federal Regulations, or any other federal regulation or statute, provides that any employee of the Federal Government who has any outstanding debt due or owing may be subject to dismissal from the federal service for failure to pay said debt unless the respondent concerned can demonstrate that sufficient facts exist with regard to the employee to whom the representation was made which establish the propriety of such claim;

(3) any person who utilizes the United States mail to obtain any publication, merchandise or service and who fails to pay or becomes delinquent in paying for any such item will be subject to prosecution for mail fraud under federal law unless the respondent concerned can demonstrate that sufficient facts exist, with regard to person to whom the representation was made, which establish the propriety of such claim; or misrepresenting, in any manner, the rights, duties or obligations of any person arising from any federal, state, or local statute, ordinance, or regulation;

(4) any respondent utilizes the services of credit reporting companies or other entities for persons who disseminate credit information in a manner which will adversely affect the public or general credit rating of any person who has become delinquent in paying any debt unless the respondent concerned can demonstrate that sufficient facts exist, with regard to the person to whom the representation was made, which establish the propriety of such claim, or misrepresenting, in any manner, that any person's public or general credit rating will be adversely affected;

(5) any letter, notice or other communication which has been prepared, originated or composed by any respondent has been prepared, originated or composed by any other person, firm or corporation;

(6) suit will be instituted to recover any delinquent debt, or that any delinquent debt will be transferred to any attorney with instructions to institute suit, or that any other legal step to collect any outstanding debt will be taken, unless a definite date is set forth for such action and such are the facts; or misrepresenting, in any manner, respondents' relationship with, or instructions to, any attorney, or the course of action that will be taken by any attorney or misrepresenting in any manner that any account has been transferred to any person or entity for collection unless those are the facts.

B. using any correspondence forms or any written materials which appear to depict official legal process.

V

For the purpose of the following provisions of this order, the terms "respondents" shall apply to each of the respondents named in Paragraph I and II of the Order.

It is further ordered, That respondents:

A. Deliver by registered mail, a copy of this Decision and Order to each of their salesmen, agents, solicitors, or other persons engaged by respondents for the promotion, sale or distribution of any of the publications, merchandise or services included in this Order, and to any person engaged by respondents to perform such duties in the future at the time such person is so engaged;

B. Obtain from each person described in Paragraph V A, a signed statement setting forth their intention to conform their business practices to the requirements of this Order; retain said statement during the period of three (3) years thereafter; and make said

statement available to the Commission's staff for inspection and copying upon reasonable notice;

C. Advise each such present and future saleman, agent, solicitor, or other person engaged by respondents for the promotion, sale or distribution of any of the publications, merchandise or services included in this Order that respondents will terminate the engagement or services of any such person, unless such person agrees to and does furnish to respondents a statement required by Paragraph V B, above; and

D. If any such person will not agree to file a statement with respondents as required by Paragraph V B above, and be bound by the provisions of this Order, the respondents shall immediately terminate the services of such person.

E. Furnish the Commission on a quarterly basis with a list, including business addresses, of those independent or outside distributors who have purchased or otherwise obtained for resale any of the publications, merchandise or services included in this Order.

VI

It is further ordered, That the respondent shall forthwith distribute a copy of this Order to each of their operating divisions.

VII

It is further ordered, That respondents shall notify the Commission at least thirty (30) days prior to any proposed change in any of the corporate respondents such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of which may affect compliance obligations arising out of this Order.

VIII

It is further ordered, That respondents shall, within sixty (60) days after the effective date of this Order, file with the Commission a report in writing setting forth in detail, the manner and form in which they have complied with this Order.

APPENDIX A
NOTICE

Attached hereto are the *pertinent provisions* of a cease and desist order entered against Grolier, Incorporated and certain of its subsidiaries, including Grolier Interstate, Inc. by the Federal Trade Commission, an agency of the Federal Government. Violation of any provision of this Order can result in severe monetary penalties to Grolier, Incorporated and Grolier Interstate, Inc. If you are employed by Grolier, Incorporated or any of its subsidiaries, you will be *required* to observe the provisions of this Order. Violation of any provision of this Order by an employee constitutes a violation of a federal law.

You should carefully read this Order before agreeing to any employment arranged with Grolier, Incorporated or any of its subsidiary companies.

_____

(President)

Grolier, Incorporated

IN THE MATTER OF

CHAMPION HOME BUILDERS CO.

Docket 9151. Interlocutory Order, March 9, 1982

ORDER DENYING COMPLAINT COUNSEL'S MOTION FOR REMAND, OR, IN THE ALTERNATIVE, MOTION TO AMEND COMPLAINT

This matter is before the Commission on the certification by the Administrative Law Judge (the "ALJ") of complaint counsel's Motion to Amend Complaint, filed December 29, 1981. Complaint Counsel has filed a "Motion to Remand Complaint Counsel's Motion to Amend the Complaint or, in the Alternative, To Amend the Complaint" and respondent has filed a "Response to Complaint Counsel's Motion to Amend Complaint."

The original complaint in this matter charges that respondent violated section 5 by failing to disclose material facts about its Solar Furnace to prospective purchasers. Complaint counsel now move the Commission to amend the complaint to state that respondent failed to disclose safety hazards inherent in the Solar Furnace. Specifically, complaint counsel would add the following underscored language to Paragraph Eleven of the original complaint:

> PAR. 11. A significant number of Solar Furnaces are subject to or potentially subject to one or more conditions which are costly to correct or may significantly affect the quality, durability, or performance of the Solar Furnaces. Such conditions include but are not limited to controller malfunctions, foam insulation expansion and air leakage, wood frame outgassing <u>and safety hazards.</u> Respondent knew or should have known and failed to disclose to purchasers of Solar Furnaces facts which relate to the existence, nature, and extent of these conditions. Respondent's failure to disclose these material facts which, if known to prospective purchasers, would have been likely to affect their purchasing decisions, was and is deceptive and unfair.

Under Rule 3.15(a), the ALJ is authorized to permit amendments of complaints when "determination of a controversy on the merits will be facilitated thereby," and under "conditions as are necessary to avoid prejudicing the public interest and the rights of the parties." However, the ALJ may enter such an order only if the amendment "is reasonably within the scope of the original complaint." *Capital Records Distributing Corp.,* 58 F.T.C. 1170 (1961). Thus, the ALJ has authority to order amendments which clarify the allegations of a complaint or which merely add examples of practices already challenged. *Century 21 Commodore Plaza Inc.,* 89 F.T.C. 237 (1977); *Cavanagh Communities,* 87 F.T.C. 143 (1976). Where a proposed amendment alters the "underlying theory" of the original complaint, however, the Commission must make the determination whether to

amend the complaint because only the Commission is authorized to determine whether there is reason to believe that the law has been violated and whether a proceeding on those amended charges would be in the public interest. *Standard Camera Corp.*, 63 F.T.C. 1238 (1963).

Complaint counsel argue that the proposed amendment does not change the underlying theory of the original complaint and that the ALJ is therefore authorized under Rule 3.15(a) to decide the motion to amend the complaint. In support of this argument, they note that the specific conditions enumerated in the complaint were expressly cited only as examples, not an exhaustive list, and that the existence of a safety hazard is just "another condition" like the ones enumerated.

The ALJ, however, disagreed. In certifying the motion to amend the complaint to the Commission, he noted that the complaint failed explicitly to mention safety hazards and that "an unsafe product may be treated differently under Section 5 than one that is just misrepresented." He concluded that the decision whether to amend the complaint was properly the Commission's.

Complaint counsel's argument is not persuasive. For a variety of reasons, an allegation of the existence of an undisclosed safety hazard is significantly different than an allegation of an undisclosed product "defect." One obvious difference is the type of harm likely to follow from each: a safety hazard poses a risk of physical as well as economic injury. In cases involving safety risks, the Commission may impose higher standards of conduct or consider different remedies than in a case involving pure economic harm. *Cf., e.g., Firestone Tire and Rubber Co.*, 81 F.T.C. 398 (1972), *affirmed*, 481 F.2d 246 (6th Cir. 1973), *cert. denied*, 414 U.S. 1112 (1973); *Pfizer, Inc.*, 81 F.T.C. 28 (1972). In addition, in considering whether an action under section 5 would be in the public interest, the Commission must also weigh the fact that other federal agencies have the primary duty to ensure the safety of certain products. For these reasons, we cannot agree with complaint counsel that a failure to disclose "safety hazards" was reasonably within the scope of a complaint alleging the failure to disclose product defects causing solely economic harm. Accordingly, the ALJ properly certified the Motion to Amend Complaint to the Commission. *Century 21 Commodore Plaza, Inc.*, 89 F.T.C. 237 (1977).

Complaint counsel urge the Commission to amend the complaint, contending that the amendment is in the public interest and would not prejudice the respondent. Respondent, on the other hand, argues that granting the amendment would unduly complicate an already complex trial, and prejudice its rights and the public interest.

Respondent further argues that there is no "reason to believe" that the Solar Furnace is a safety hazard or that respondent knew or should have known of the existence of the safety hazard.

At the outset, it is clear that amending the complaint at this relatively early stage of the proceeding, where discovery is still ongoing and trial some months distant, would not prejudice respondent. Respondent would have adequate time to respond fully to the charges in the amended complaint. *Exquisite Form Brassiere, Inc. v. FTC,* 301 F.2d 499 (D.C. Cir. 1961), *cert. denied,* 369 U.S. 888 (1962); *James Carpets, Inc.,* 81 F.T.C. 1043, 1046 (1972). In addition, it is well established that the Commission may freely grant leave to amend complaints when the public interest so requires. *Forster Mfg. Co. v. FTC,* 335 F.2d 47, 50 (1st Cir. 1964), *cert. denied,* 380 U.S. 906 (1965).

Nevertheless, the Commission is not persuaded that the public interest would be served, or the trial of this case facilitated, by amending the complaint as moved by complaint counsel. In the first instance, the Commission is not persuaded by the evidence proffered by complaint counsel that there is a reason to believe that respondent violated section 5 by failing to disclose an inherent safety risk about which it knew or should have known. Complaint counsel cite the opinion of one mechanical engineering expert that some of respondent's products could, under some circumstances, create a fire hazard and that some of respondent's products did not conform with national fire and electrical safety codes. However, complaint counsel have not presented information creating a reason to believe that any of respondent's products did, in fact, cause fires or injuries, or that respondent reasonably should have known of the fire hazard potential at the relevant times. The Commission cannot say, on the basis of the evidence before it, that it would be in the public interest to bring an action on the proposed amendment. Accordingly,

It is ordered That Complaint Counsel's Motion to Remand, or, in the alternative, to Amend the Complaint, be, and it hereby is, denied.

IN THE MATTER OF

JIM WALTER CORPORATION

Docket 8986. Interlocutory Order, March 15, 1982

ORDER DEFINING THE SCOPE OF THE PROCEEDINGS ON REMAND AND DIRECTING COMPLAINT COUNSEL TO SUBMIT A PROPOSED AMENDED COMPLAINT

On March 13, 1981, the Commission directed complaint counsel and respondent to file briefs presenting their views as to further disposition of this matter.

Complaint counsel argue that under the standards enunciated by the reviewing court, *Jim Walter Corp. v. FTC,* 625 F.2d 679 (5th Cir. 1980), staff could prove in further hearings the existence of two relevant geographic markets: (a) the 26-state area extending from Texas to and including New York and Massachusetts; and (b) the 41 states east of the Rocky Mountains. Complaint counsel also argue that the Commission's prior product market determinations were correct and continue to be correct in both of the proposed geographic markets and that the acquisition violates Section 7 of the Clayton Act, 15 U.S.C. 18, in either or both geographic markets. Complaint counsel also assert that their case would not be affected even if elastomeric roofing materials were included in the product market,[1] and conclude by asserting that a new hearing would be in the public interest both because the acquisition assertedly violates Section 7 and because complaint counsel think there is a strong likelihood of effective relief.

Respondent, Jim Walter Corporation ("JWC"), on the other hand, argues that principles of fairness and finality, as well as the Commission's rules, require a dismissal of the complaint. Even if a dismissal is not required, JWC argues that new evidentiary hearings are not appropriate inasmuch as they would necessarily entail extended discovery and the consideration of current evidence relating to market definition (product and geographic), market share data and the structure of the market, thereby, in JWC's view, causing considerable waste of resources. JWC further argues that the 26-state area and 41-state area asserted by complaint counsel are not relevant markets within which to assess the effects of the acquisition and that, in any event, complaint counsel have shown neither an ability to prove either actual or potential anticompetitive effects nor the appropriateness of divestiture as a remedy.

[1] "Elastomeric roofing materials" consist of solid-preformed sheets and liquids. The term includes the synthetic rubbers neoprene and Hypalon as well as acrylic, butyl, rubberized asphalt, urethane and silicone.

The Commission rejects JWC's assertion that dismissal of the complaint is required. The court of appeals "vacate[d] the FTC decision and remand[ed] the case for reconsideration in light of [the court's] opinion" and "for such proceedings * * * as may be appropriate." 625 F.2d at 684, 678. In so doing, the court suggested several areas of further inquiry. Indeed, any fair reading of the court's opinion shows that the court fully expected that the remand might involve a new trial of some, or several, issues. 625 F.2d at 681, 683–684. Settled principles of administrative law establish that this disposition of the case was well within the court's discretion. *E.g., Ford Motor Co. v. NLRB,* 305 U.S. 364, 372–375 (1939).[2] While JWC's argument for dismissal is not a frivolous one, the decision whether to dismiss or proceed must, given the court's mandate allowing the Commission to proceed, depend upon whether the Commission has reason to believe both that the challenged conduct violates the law and that further proceedings are in the public interest.

In the present case, the Commission has considered the court's decision, as well as the arguments and factual statements set out in the briefs of the parties submitted in response to the Commission's Order of March 13, 1981. We have determined that the present record, and the factual assertions made in the parties' briefs, give the Commission reason to believe that both (1) asphalt and tar roofing products and (2) asphalt and tar proof products as well as elastomeric roofing materials are appropriate markets within which to assess the effects of the acquisition in both (1) the 26-state area and (2) the 41-state area advanced by complaint counsel. The Commission also has reason to believe that the acquisition may have had, or may cause, anticompetitive effects in all of these markets.

The Commission also believes that the public interest would be best served by holding further hearings to determine both the legality of the acquisition and, should the transaction be found illegal, the appropriate remedy. Given the time elapsed since the acquisition was consummated, the Commission has determined that it is appropriate on remand for the Administrative Law Judge to focus upon the industry as it has developed in the intervening years and, should the acquisition be found unlawful, to consider what, if any, remedy is most appropriate, given the present structure of the market(s).[3] *See e.g., United States v. E.I. du Pont de Nemours & Co.,* 353 U.S. 586, 597–598 (1957).

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[2] The Commission similarly rejects JWC's argument that Commission Rule 3.55, 16 C.F.R. 3.55, requires dismissal. As JWC points out, Rule 3.55 governs petitions for reconsideration of Commission decisions. The Rule has nothing to do with the disposition of this matter on remand.

[3] Post-acquisition evidence is solicited on remand here because of our decision that evidence of a new product line—elastomeric roofing materials—in addition to the tar and asphalt roofing materials should be included in the

(Continued)

In view of the comments by the court of appeals regarding the possible interest of *Celotex Corporation,* 625 F.2d at 681, the Commission believes Celotex should be joined as a respondent on remand. Also, while the original complaint in this matter alleged only a violation of Section 7 of the Clayton Act, 15 U.S.C. 18, the Commission believes that on remand the Administrative Law Judge should consider the legality of the acquisition under Section 5 of the FTC Act, 15 U.S.C. 45, as well as under Section 7.

In light of the Commission's determination to (1) order retrial of the case; (2) join Celotex Corporation as a party; (3) allege a possible violation of Section 5 of the FTC Act; (4) allege two relevant product markets and adverse competitive effects in two geographic markets; and (5) evaluate the post-acquisition effects of the acquisition, the administrative complaint must be amended. However, Commission Rule 3.15(a), 16 C.F.R. 3.15(a), plainly provides that the scope of the required amendments is beyond the authority of an Administrative Law Judge to order and amendments such as those required by this Order may be issued only by order of the Commission, upon certification by an Administrative Law Judge. In the present case the matter is pending before the Commission on remand from the court of appeals and the parties have already submitted briefs discussing the disposition of the case on remand. Although the present posture of the case would thus allow the Commission to prepare and direct the issuance of an amended administrative complaint, nonetheless the Commission believes it would be better practice for complaint counsel to prepare a proposed amended complaint that is consistent with the terms of this Order. Because this matter is already before the Commission, it makes no sense for the amended complaint to be certified to the Commission by an Administrative Law Judge. Accordingly, to avoid unnecessary duplication, this Order instructs complaint counsel to submit, within 14 days, directly to the Commission, a proposed amended complaint which the Commission might then direct the Secretary to issue and serve. It also provides respondent an opportunity to address the proposed amendments in writing. Accordingly,

It is hereby ordered That within 14 days after the issuance of the Order complaint counsel submit to the Commission, and serve upon

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assessment of the anticompetitive effects of this acquisition. Although post-acquisition evidence should not be given "too much weight," *Federal Trade Commission v. Consolidated Foods Corp.,* 380 U.S. 592, 598 (1965), principally because it is within the power of the acquiring company to manipulate the acquired assets in a manner favorable to its case, *United States v. Continental Can Co.,* 378 U.S. 441, 463 (1964), it is nevertheless appropriate to consider post-acquisition evidence in particular Section 7 cases. There is authority for relying on "the best information available" in assessing a merger as old as this one (ten years). *Consolidated Foods Corp.,* 380 U.S. at 605–06 (Stewart, J. concurring in the judgment).

counsel for Jim Walter Corporation, a proposed amended complaint that is consistent with this order;

It is further ordered That if Jim Walter Corporation wishes to address the proposed amended complaint, it shall file its comments within 14 days of service upon it of the proposed amended complaint; and

It is further ordered That upon issuance of the amended complaint this matter is remanded to the Administrative Law Judge to conduct further proceedings consistent with the opinion of the court of appeals and this Order.

Commissioner Pertschuk did not participate.

IN THE MATTER OF

HERCULES INCORPORATED, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 7 OF THE CLAYTON ACT

Docket C-1794. Final Order, Sept. 23, 1970—Modified Order, Apr. 8, 1982.

This order reopens the proceeding and modifies the Commission's order issued on September 23, 1970, 77 F.T.C. 1242, 35 F.R. 16366, by deleting Paragraphs IV and VIII from the order, so as to allow the company to acquire domestic rope producers without prior Commission approval and to relieve respondent of the obligation of notifying the Commission of any change in the corporate organization.

ORDER REOPENING PROCEEDING AND MODIFYING ORDER

By petition filed December 1, 1981, respondent Columbian Rope Company ("Columbian") requests, pursuant to Section 5(b) of the Federal Trade Commission Act (15 U.S.C. 45(b)), that Paragraph IV and VIII of the Comission's Order issued in this matter on September 23, 1970, be modified so that Columbian no longer requires the Commission's prior approval to acquire, directly or indirectly, the whole or any part of the stock, share capital or assets of any company involved in the manufacture and sale of rope in the United States. Columbian also sought to delete the only other order provision binding Columbian, Paragraph VIII, which requires notice of changes in corporate organization.

Pursuant to Section 2.51 of the Commission's Rules of Practice and Procedure, the petition was placed on the public record for thirty days. No comments were received.

Upon consideration of the petition and its supporting materials the Commission finds that elimination of Paragraphs IV and VIII is in the public interest.

Accordingly, *it is ordered,* that the proceeding be, and it hereby is, reopened for the purpose of modifying the Order entered therein;

It is further ordered, That the Paragraph IV and Paragraph VIII shall terminate upon service of this order.

IN THE MATTER OF

MASTIC CORPORATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3086. Complaint, April 12, 1982—Final Order, April 12, 1982

This consent order requires Mastic Corporation, a manufacturer and seller of residential vinyl siding products, among other things, to cease paying for or disseminating any advertisement for vinyl siding that contains an energy related claim. The order requires the firm to distribute a copy of the order to all personnel engaged in the promotion of vinyl siding. Mastic Corporation is required to provide its distributors and retailers with a copy of the order together with a letter explaining its provisions.

Appearances

For the Commission: *Steven H. Meyer* and *Michael Dershowitz.*

For the respondent: *Daniel D. Nayer, Wilmer, Cutler & Pickering,* Washington, D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by that Act, the Federal Trade Commission, having reason to believe that Mastic Corporation, a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of Section 5 of the Federal Trade Commission Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this complaint, stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Mastic is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Indiana, with its principal office and place of business located at 131 South Taylor St., South Bend, Indiana.

PAR. 2. Respondent is now, and for some time past, has been engaged in the manufacture, advertising, promotion, offering for sale, sale and distribution of residential vinyl siding products.

PAR. 3. In the course and conduct of its business, respondent now causes, and for some time past has caused, its residential vinyl siding products, when sold, to be shipped from its manufacturing plants in South Bend, Indiana and Stuarts Draft, Virginia to its distributors and retailers in various States of the United States. For the purpose

of inducing the purchase of its residential vinyl siding products by the consuming public, respondent disseminates and causes the dissemination of, and for some time past has disseminated and caused the dissemination of certain advertisements and promotional materials through the use of the United States mail. Accordingly, respondent maintains, and has maintained, a substantial course of business, including the acts and practices as hereinafter set forth, which are in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. Through the use of said advertisements and other promotional materials, respondent has made statements with regard to its vinyl siding products. Among these are statements that respondent's vinyl siding:

Conserves Energy

* * *

Lowers Fuel Bills

* * *

. . .is a Non-conductor of heat or cold

* * *

. . .is a 24.8% better insulator than aluminum

* * *

. . .helps to stop air infiltration

PAR. 5. By and through the use of statements set forth in Paragraph Four, respondent has represented and is now representing directly or by implication, that:

a. vinyl siding, by itself, significantly conserves energy;
b. vinyl siding, by itself, significantly lowers fuel bills;
c. vinyl siding, by itself, significantly reduces heat loss through the exterior walls of a home;
d. vinyl siding does not conduct heat or cold;
e. vinyl siding is superior to aluminum siding because it significantly exceeds aluminum siding in insulation value;
f. vinyl siding, in all cases, significantly reduces air infiltration into and out of a home.

PAR. 6. In truth and in fact, contrary to respondent's representations set forth in Paragraph Five:

a. vinyl siding, by itself, does not significantly conserve energy;
b. vinyl siding, by itself, does not significantly lower fuel bills;

c. vinyl siding, by itself, does not significantly reduce heat loss through the exterior walls of a home;

d. vinyl siding, like all materials, conducts heat; indeed, because it is a very thin material, vinyl siding has a high rate of conductance.

e. vinyl siding does not exceed aluminum siding in insulation value; there is little, if any, difference in the insulation value of vinyl and aluminum siding.

f. vinyl siding does not, in all cases, significantly reduce air infiltration into and out of a home; indeed, in many cases vinyl siding has little, if any, effect on air infiltration.

Therefore, said advertisements and promotional materials were, and are false, deceptive, misleading or unfair.

PAR. 7. At the time respondent made the statements and representations alleged in Paragraphs Four and Five, it did not possess and rely upon a reasonable basis for such representations. Therefore, the statements and representations set forth and alleged in Paragraphs Four and Five were and are unfair, deceptive, or misleading.

PAR. 8. By and through the use of the aforementioned advertisements and promotional materials, respondent has represented and is now representing, directly or by implication, that it had a reasonable basis for the statements and representations set forth and alleged in Paragraphs Four and Five. In truth and in fact, respondent had no reasonable basis for the statements and representations set forth and alleged in Paragraphs Four and Five. Therefore, said advertisements and promotional materials were and are unfair, deceptive or misleading.

PAR. 9. The use by respondent of the aforesaid false, misleading, unfair or deceptive advertising and promotional materials, and the placement in the hands of its distributors and retailers of the means and instrumentalities by and through which others have used the aforesaid false, misleading, unfair or deceptive advertisements and promotional materials have had, and now have, the capacity and tendency to mislead consumers into the erroneous and mistaken belief that said statements and representations were and are true and complete, and into the purchase of respondent's vinyl siding products by reason of said erroneous and mistaken belief.

PAR. 10. The acts and practices of respondent as herein alleged, were and are all to the prejudice and injury of the public and of respondent's competitors, and constituted and now constitute unfair methods of competition and unfair and deceptive acts and practices in or affecting commerce, in violation of Section 5 of the Federal

Trade Commission Act. The acts and practices of respondent, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it has reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Mastic Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of Indiana, with its office and principal place of business located at 131 South Taylor St., in the City of South Bend, State of Indiana.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For purposes of this order, the following definitions shall apply:

Advertisement means any illustration, depiction, written or oral

statement, or other representation, whether the same appears in a television or radio broadcast, newspaper or label, brochure, leaflet, circular, mailer, book insert, journal, catalog, sales promotion material, other periodical literature, billboard, public transit card, point of purchase display, or in any other media.

Energy related claim means any general or specific representation that, directly or by implication, describes or refers to energy savings, efficiency or conservation, fuel savings, insulating value, air infiltration, conductance of heat, or heat gain or loss.

Vinyl siding product means any vinyl siding product made from vinyl and used for residential purposes, and includes siding which is directly backed with material such as backerboard or drop-in panels. For purposes of this order, *vinyl siding product* does not include *siding systems,* which are a combination of vinyl siding and any other product(s) which contain *insulation* as that word is defined by the Commission's Trade Regulation Rule Concerning the Labeling and Advertising of Home Insulation, 16 CFR Part 460 (1980).

PART I

It is ordered, That respondent Mastic Corporation, a corporation, its successors and assigns, and its officers, agents, representatives and employees directly or through any corporation, subsidiary, division, or other device, in connection with the advertising, offering for sale, sale or distribution of any vinyl siding product in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from disseminating, causing to be disseminated, or paying in whole or in part for any advertisement which contains an energy related claim.

PART II

It is further ordered, That for a period of five years following the date of service of this Order, respondent deliver a copy of this Order to all present and future employees, personnel, or agents and representatives of respondent engaged in the creation, design, printing or dissemination of any advertisement promoting respondent's vinyl siding products; and that respondent obtain a signed statement acknowledging receipt of the order from each said person or entity.

PART III

It is further ordered, That respondent shall:

1. Within thirty (30) days after the date of service of this order, send the following material via first class mail to every person or firm that has been a distributor of respondent's vinyl siding products during the year prior to the date of service of this order, and to every person or firm that has been a retailer of respondent's vinyl siding products that respondent can identify from the warranty registration cards which, between July, 1980 and the date of service of this order, were both issued by and returned to respondent:

a. a copy of this order, and

b. a cover letter which informs the recipient in plain and readily understood language that Mastic has agreed with the Federal Trade Commission not to make energy related claims for its vinyl siding products, that the recipient should make no energy related claims for Mastic's vinyl siding products in the future, and that the recipient should stop using any Mastic promotional material which contains any energy related claims.

2. Supply to the Federal Trade Commission upon request the names and addresses of those parties to whom respondent distributed the material required by Paragraph 1 of PART III of this order.

PART IV

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this order.

PART V

It is further ordered, That the respondent shall within sixty (60) days after service upon it of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this order.

IN THE MATTER OF

BRUNSWICK CORPORATION, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket 9028. Final Order, Aug. 14, 1980—Modifying Order, April 29, 1982

This order modifies the Commission's final order issued on August 14, 1980, 96 F.T.C. 151, by adding Paragraphs IX and X to the order, in accordance with the decision and judgment of the Eighth Circuit Court of Appeals. The new paragraphs: (1) limit Yamaha's liability in this matter solely to violations of Section 5 of the Federal Trade Commission Act; and (2) insures that nothing in the order prevents respondents from imposing upon themselves, their dealers and distributors, vertical restraints in connection with the sale by them for resale in the U.S. of outboard motors.

MODIFIED ORDER TO CEASE AND DESIST

The Commission having issued a final cease and desist order herein on August 14, 1980, and such order having been modified and affirmed by the United States Court of Appeals for the Eighth Circuit, and the Supreme Court having denied the petition for certiorari filed by respondents Brunswick Corporation and Mariner Corp.:

Now, therefore, *it is ordered,* that the aforesaid order to cease and desist be, and hereby is, modified in accordance with the decision and judgment of the Court of Appeals to read as follows:

For the purposes of this Order:

a) *Brunswick* shall mean the Brunswick Corporation, together with its present and future domestic and foreign subsidiaries, affiliates, joint ventures, related corporations (including Mariner Corp.), and corporations controlled by Brunswick Corporation; and all successors to Brunswick Corporation and their domestic and foreign subsidiaries, affiliates, joint ventures and related corporations; and all corporations controlled by the successors of Brunswick Corporation.

b) *Yamaha* shall mean Yamaha Motor Co., Ltd., together with its present and future domestic and foreign subsidiaries, affiliates, joint ventures, related corporations, and corporations controlled by Yamaha Motor Co., Ltd.; and all successors to Yamaha Motor Co., Ltd. and their domestic and foreign subsidiaries, affiliates, joint ventures

and related corporations; and all corporations controlled by the successors of Yamaha Motor Co., Ltd.

c) *Mariner* shall mean Mariner Corp., together with its present and future domestic and foreign subsidiaries, affiliates, joint ventures, related corporations, and corporations controlled by Mariner Corp.; and all successors to Mariner Corp. and their domestic and foreign subsidiaries, affiliates, joint ventures and related corporations; and all corporations controlled by the successors of Mariner Corp.

I.

It is ordered, That within 90 days of the date this Order becomes final, Brunswick and Mariner shall sell to Yamaha, and Yamaha shall buy from Brunswick and Mariner, all capital stock, bonds, debentures, and other securities and other interests held by Brunswick and Mariner in Sanshin Kogyo Co., Ltd. ("Sanshin"). The purchase price shall be equal in dollars to the value of the net tangible assets per share, computed and adjusted to the last day of the six month term immediately preceding the date of the sale.

II.

It is further ordered, That, on or before 90 days from the date this Order becomes final, Brunswick, Yamaha, and Mariner shall rescind in all respects the Joint Venture Agreement, and the agreements attached thereto, entered into on November 21, 1972, and all agreements modifying the Joint Venture Agreement and the agreements attached thereto, shall consider them null and void, and shall cease and desist from observing or enforcing the terms of said agreements.

III.

It is further ordered, That from the date this Order becomes final, Brunswick and Mariner shall cease any and all representation on the board of directors of Sanshin, cease and desist from taking any steps to nominate, seat, or admit any representatives of Brunswick and Mariner to the board of directors of Sanshin, and cease and desist from exercising any of the rights of a shareholder of Sanshin except the right to receive dividends.

IV.

It is further ordered, That from the date this Order becomes final, neither Brunswick nor Mariner shall enter into, continue to be a party to, or enforce any agreement which in whole or in part prevents a manufacturer, seller, or distributor of outboard motors from manufacturing, selling, or distributing such motors in the United States, its territories or possessions.

V.

It is further ordered, That from the date this Order becomes final, Yamaha shall not enter into, continue to be a party to, or observe any agreement which in whole or in part prevents Yamaha from manufacturing, selling, or distributing outboard motors in the United States, its territories or possessions.

VI.

It is further ordered, That Brunswick, Yamaha, and Mariner shall, for a period of three years from the date this Order becomes final, cease and desist from acquiring, directly or indirectly, through subsidiaries or otherwise, without the prior approval of the Federal Trade Commission, all or any part of the stock or share capital of any concern, corporate or noncorporate, engaged in the production, distribution or sale of outboard motors in or for the United States, or capital assets pertaining to such production, distribution or sale of such motors in or for the United States.

VII.

It is further ordered, That Brunswick, Yamaha, and Mariner notify the Federal Trade Commission at least 30 days prior to any proposed change in its corporate structure such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any change in the corporation which may affect compliance obligations arising out of this Order.

VIII.

It is further ordered, That Brunswick, Yamaha, and Mariner shall within 120 days of the date this Order becomes final, submit in writing to the Federal Trade Commission a verified report setting forth in detail the manner and form in which Brunswick, Yamaha,

and Mariner each intends to comply or has complied with this Order. Brunswick, Yamaha, and Mariner shall submit such other information as may from time to time be requested by the Commission.

IX.

Nothing in this Order or in the opinions of the Commission in this case shall be construed as a finding or conclusion that Yamaha has violated Section 7 of the Clayton Act. All findings and relief against Yamaha are based solely on Section 5 of the Federal Trade Commission Act.

X.

Nothing in this Order, including in particular Paragraphs IV or V hereof, shall prevent either Brunswick, Mariner, or Yamaha, respectively, from imposing upon itself, its dealers, or its distributors, ancillary vertical restraints in connection with the sale by it for resale in the United States of outboard motors.

IN THE MATTER OF

VINYL IMPROVEMENT PRODUCTS COMPANY

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3087. Complaint, April 30, 1982—Decision, April 30, 1982

This consent order requires Vinyl Improvement Products Company (VIPCO), a manufacturer and seller of residential vinyl siding products, among other things, to cease paying for or disseminating any advertisement for vinyl siding that contains an energy-related claim. The order requires the firm to distribute a copy of the order to all personnel engaged in the promotion of vinyl siding. Further, VIPCO must mail to each business entity which has sold or distributed its products during the previous year a letter which advises that vinyl siding by itself does not save energy.

Appearances

For the Commission: *Steven H. Meyer* and *Michael Dershowitz.*

For the respondent: *Joseph J. Lyman, Lyman, Kyhos & Rales,* Washington, D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by that Act, the Federal Trade Commission, having reason to believe that Vinyl Improvement Products Company, a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of Section 5 of the Federal Trade Commission Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this complaint, stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Vinyl Improvement Products Company is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Ohio, with its principal office and place of business located at 1441 Universal Drive, Columbus, Ohio.

PAR. 2. Respondent is now, and for some time past, has been engaged in the manufacture, advertising, promotion, offering for sale, sale and distribution of residential vinyl siding products.

PAR. 3. In the course and conduct of its business, respondent now causes, and for some time has caused, its residential vinyl siding products, when sold, to be shipped from its manufacturing plant in Columbus, Ohio to its distributors and retailers in various States of

the United States. For the purpose of inducing the purchase of its residential vinyl siding products by the consuming public, respondent disseminates and causes the dissemination of, and for some time has disseminated and caused the dissemination of certain advertisements and promotional materials through the use of the United States mail. Accordingly, respondent maintains, and has maintained, a substantial course of business, including the acts and practices as hereinafter set forth, which are in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. Through the use of said advertisements and other promotional materials, respondent has made statements with regard to its vinyl siding products. Among these are the following statements:

Conserve energy

* * * * * * *

Lowers your fuel bills summer and winter

Enjoy a significant savings on heating costs . . .

* * * * * * *

Vinyl does not retain heat or cold . . . This resistance to heat and cold makes vinyl a superior Energy Saving material for insulation.

. . . can really help protect the home against expensive energy loss. Because it is solid vinyl, which does not readily transfer heat or cold, it helps keep out winter's freezing and summer's sweltering temperatures.

* * * * * * *

. . . insulates 1000 times better than ordinary aluminum siding.

Better insulation value than traditional siding such as aluminum or steel.

PAR. 5. By and through the use of statements set forth in Paragraph Four, respondent has represented and is now representing directly or by implication, that:

a. vinyl siding, by itself, significantly conserves energy;

b. vinyl siding, by itself, affords significant fuel bill savings;

c. vinyl siding, by itself, is an effective insulating material because it is heat resistant;

d. vinyl siding is superior to aluminum siding because it significantly exceeds aluminum siding in insulation value;

PAR. 6. In truth and in fact, contrary to respondent's representations set forth in Paragraph Five:

a. vinyl siding, by itself, does not significantly conserve energy;

b. vinyl siding, by itself, does not afford significant fuel bill savings;

c. vinyl siding, by itself, is not an effective insulating material and is not heat resistant; indeed, because it is a very thin material, vinyl siding conducts heat at a high rate.

d. vinyl siding does not exceed aluminum siding in insulation value; indeed, there is little, if any, difference in the insulation value of vinyl and aluminum siding.

Therefore, said advertisements and promotional materials were, and are false, deceptive, misleading or unfair.

PAR. 7. At the time respondent made the statements and representations alleged in Paragraphs Four and Five, it did not possess and rely upon a reasonable basis for such representations. Therefore, the statements and representations set forth and alleged in Paragraphs Four and Five were and are unfair, deceptive, or misleading.

PAR. 8. By and through the use of the aforementioned advertisements and promotional materials, respondent has represented and is now representing, directly or by implication, that it had a reasonable basis for the statements and representations set forth and alleged in Paragraphs Four and Five. In truth and in fact, respondent had no reasonable basis for the statements and representations set forth and alleged in Paragraphs Four and Five. Therefore, said advertisements and promotional materials were and are unfair, deceptive or misleading.

PAR. 9. The use by respondent of the aforesaid false, misleading, unfair or deceptive advertising and promotional materials, and the placement in the hands of its distributors and retailers of the means and instrumentalities by and through which others have used the aforesaid false, misleading, unfair or deceptive advertisements and promotional materials have had, and now have, the capacity and tendency to mislead consumers into the erroneous and mistaken belief that said statements and representations were and are true and complete, and into the purchase of respondent's vinyl siding products by reason of said erroneous and mistaken belief.

PAR. 10. The acts and practices of respondent as herein alleged, were and are all to the prejudice and injury of the public and of respondent's competitors, and constituted and now constitute unfair methods of competition and unfair and deceptive acts and practices

in or affecting commerce, in violation of Section 5 of the Federal Trade Commission Act. The acts and practices of respondent, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it has reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Vinyl Improvement Products Company is a corporation organized, existing and doing business under and by virtue of the laws of the State of Ohio, with its office and principal place of business located at 1441 Universal Drive, in the City of Columbus, State of Ohio.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For purposes of this order, the following definitions shall apply:

Advertisement means any illustration, depiction, written or oral statement, or other representation, whether the same appears in a television or radio broadcast, newspaper or label, brochure, leaflet, circular, mailer, book insert, journal, catalog, sales promotion material, other periodical literature, billboard, public transit card, point of purchase display, or in any other media.

Energy-related claim means any general or specific representation that, directly or by implication, describes or refers to energy savings, efficiency or conservation, fuel savings, insulating value, air infiltration, conductance of heat, or heat gain or loss.

Vinyl siding product means any vinyl siding product made from vinyl and used for residential purposes, and includes siding which is directly backed with material such as backerboard or drop-in panels. For purposes of this order, "vinyl siding product" does not include "siding systems," which are a combination of vinyl siding and any other product(s) which contain "insulation" as that word is defined by the Commission's Trade Regulation Rule Concerning the Labeling and Advertising of Home Insulation, 16 CFR 460 (1980).

PART I

It is ordered, That respondent Vinyl Improvement Products Company, a corporation, its successors and assigns, and its officers, agents, representatives and employees directly or through any corporation, subsidiary, division, or other device, in connection with the advertising, offering for sale, sale or distribution of any vinyl siding product in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from disseminating, causing to be disseminated, or paying in whole or in part for any advertisement which contains an energy-related claim.

PART II

It is further ordered, That respondent forthwith deliver a copy of this order to all present and future employees, personnel, or agents and representatives of respondent engaged in the creation, design, printing or dissemination of any advertisement promoting respondent's vinyl siding products; and that respondent obtain a signed statement acknowledging receipt of the order from each said person or entity.

PART III

It is further ordered, That respondent shall:

1. within thirty (30) days from the date of service of this order, send on Vinyl Improvement Products Company stationery, via first class mail, the letter attached hereto as Exhibit A, to each business entity which respondent's records show has been engaged in the offering for sale, sale or distribution of respondent's vinyl siding products directly or indirectly to the consuming public within one year prior to the date of service of this order; and

2. supply to the Federal Trade Commission upon request the names and addresses of those parties to whom respondent distributed the material required by Paragraph 1 of PART III of this order.

PART IV

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this order.

PART V

It is further ordered, That the respondent shall within sixty (60) days after service upon it of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this order.

EXHIBIT A

- ON VIPCO STATIONERY -

Dear Distributor or Retailer:

Some of the promotional materials which have been used for vinyl siding have contained claims that vinyl siding can produce energy savings. Because vinyl siding, by itself, does not save energy, we no longer make such claims. This is to advise you that you should stop representing that vinyl siding, itself, is an energy savings material.

You should note, however, that this applies only to energy savings claims made for vinyl siding alone, and not to advertising for insulation products such as Barrier Board. The labeling and advertising of insulation is covered by the FTC Home

Insulation Rule. Please remember that the Rule requires that the Fact Sheets we have distributed for Barrier Board must be given to the ultimate consumer whenever this product is sold. If you have any questions about the materials we have provided, or advertisements that you have developed, we would be pleased to advise you on such matters.

Sincerely,

VINYL IMPROVEMENT PRODUCTS COMPANY
(VIPCO)

In the Matter of

GENERAL ELECTRIC COMPANY

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket C-3088. Complaint, May 4, 1982—Decision, May 4, 1982

This consent order requires a Fairfield, Conn. diversified, industrial company, among other things, to divest its stock in Applicon, a major producer of stand-alone, turnkey, interactive graphics computer aided design/computer aided manufacturing ("CAD/CAM") systems, under a two-part divestiture plan to be completed by March 31, 1982. Pending divestiture, the order prohibits GE from exerting any influence over Applicon's operations; voting its stock in a manner which would be contrary to that in which it votes all other shares; and obtaining, from Applicon, confidential information of any kind. Additionally, for a five-year period, any GE employee who was in any way affiliated with Applicon is barred from serving in any position in Calma Company, a Sunnyvale, Calif. subsidiary of United Telecommunications, Inc., including its board of directors; prohibited from disclosing confidential information received during their tenure with Applicon, and barred from intervening in any of Calma's business operations. GE is also prevented from discriminating against Applicon, when purchasing CAD/CAM systems and products and restricted, for a ten-year period, from acquiring any interest in any firm engaged in the manufacture and sale of CAD/CAM products without prior Commission approval.

Appearances

For the Commission: *George S. Cary, Daniel J. Yakoubian* and *Donna Bowling.*

For the respondent: *Joseph Handors,* in-house counsel, Fairfield, Conn.

Complaint

The Federal Trade Commission, having reason to believe that respondent, subject to the jurisdiction of the Commission, has acquired Calma Company ("Calma"), a wholly-owned subsidiary of United Telecommunications, Inc., in violation of Section 7 of the Clayton Act, as amended (15 U.S.C. 18), and Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45), and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, pursuant to Section 11 of the Clayton Act (15 U.S.C. 21) and Section 5(b) of the Federal Trade Commission Act (15 U.S.C. 45(b)), stating its charges as follows:

I. DEFINITIONS

1. For purposes of this complaint, the following definitions shall apply:

(a) *Respondent* shall mean General Electric Company, a corporation, and its subsidiaries, affiliates, successors, and assigns; and

(b) *Stand-alone, turnkey, interactive graphics computer aided design/computer aided manufacturing ("CAD/CAM") systems* shall mean computer hardware and software products consisting of: (i) a cathode ray tube display; (ii) various input devices including a standard alphanumeric keyboard, a programmable function keyboard, and an electronic pen and tablet; (iii) various output devices including plotters; (iv) a central processing unit consisting of one or more 16 or 32 bit minicomputers; and, (v) various operating systems and applications software packages.

II. RESPONDENT

2. Respondent is a corporation organized and doing business under and by virtue of the laws of the State of New York with its executive offices at 3135 Easton Turnpike, Fairfield, Connecticut.

3. Respondent is a diversified, industrial company with operations in consumer products and services, industrial products and components, technical systems and materials, power systems, coal mining, and industrial electronics. In 1979, Respondent had total assets of $16.6 billion and total sales of $22.5 billion.

4. At all times relevant herein, Respondent has been and is now engaged in commerce within the meaning of the Clayton Act, as amended, and is a corporation whose business is in or affecting commerce within the meaning of the Federal Trade Commission Act, as amended.

III. CALMA COMPANY

5. At the time of the acquisition, Calma was a corporation organized and doing business under and by virtue of the laws of the State of California, with its principal executive offices at 527 Lakeside Drive, Sunnyvale, California.

6. Calma is engaged in the production and servicing of CAD/CAM systems. In 1979 Calma had U.S. sales of approximately $21.0 million and was the third largest U.S. producer of CAD/CAM systems.

7. At all times relevant herein, Calma has been and is now

engaged in commerce within the meaning of the Clayton Act, as amended, and is a corporation whose business is in or affecting commerce within the meaning of the Federal Trade Commission Act, as amended.

IV. APPLICON INCORPORATED

8. Applicon is a corporation organized and doing business under and by virtue of the laws of the State of Massachusetts, with its principal executive offices at 32 Second Ave., Burlington, Massachusetts.

9. Applicon is engaged in the production and servicing of CAD/CAM systems. In 1980, its total assets were $28.8 million and its total U.S. sales were approximately $37.0 million. In 1980, Applicon was the second largest U.S. producer of CAD/CAM systems.

10. From approximately June 1, 1971, Respondent has been and is now the largest single holder of common stock in Applicon.

11. From approximately June 1, 1971, Respondent has had and now has substantial opportunities to influence the business operations of Applicon.

12. At all times relevant herein, Applicon has been and is now engaged in commerce within the meaning of the Clayton Act, as amended, and is a corporation whose business is in or affecting commerce within the meaning of the Federal Trade Commission Act, as amended.

V. ACQUISITION

13. On December 5, 1980, General Electric and United Telecommunications entered into an agreement under which Respondent agreed to purchase all the outstanding shares of Calma, for $100 million plus additional incentive payments not to exceed $70 million, which are contingent upon cumulative sales of Calma during the 4-year period of January 1, 1981 through December 31, 1984.

VI. TRADE AND COMMERCE

14. The relevant line of commerce in which to evaluate the effects of GE's acquisition of Calma is CAD/CAM systems and submarkets thereof, and the relevant section of the country is the United States as a whole.

15. Sales of CAD/CAM systems in the United States are substantial, amounting to an estimated $213 million in 1979.

16. Applicon and Calma are and have been for many years substantial and actual competitors in the manufacture and sale of CAD/CAM systems.

17. In the year 1979 Applicon had sales of CAD/CAM systems in the United States of approximately $37.0 million accounting for approximately 17.3% of total U.S. sales. Calma had sales of CAD/CAM systems in the United States of approximately $21.0 million in 1979 accounting for approximately 9.8% of total U.S. sales.

18. Concentration in the manufacture and sale of CAD/CAM systems is high. In 1979, the top four firms accounted for approximately 69.3% and the top six firms approximately 83.8% of U.S. sales of CAD/CAM systems.

19. On a *pro-forma* basis, the acquisition of Calma increased the 1979 four-firm concentration from approximately 69.3% to approximately 78.2% and reduced the number of substantial competitors to five from six.

20. Barriers to entry into the manufacture and sale of CAD/CAM systems are substantial.

VII. EFFECTS OF THE ACQUISITION

21. The effect of the acquisition of Calma by Respondent may be substantially to lessen competition and to create a monopoly in the manufacture and sale of CAD/CAM systems in the United States in the following ways, among others:

(a) substantial actual and potential competition between Applicon and Calma and other firms in the manufacture and sale of CAD/CAM systems has been substantially lessened;

(b) already high concentration in the manufacture and sale of CAD/CAM systems has been increased; and

(c) the likelihood of eventual deconcentration may be lessened.

VIII. THE VIOLATION CHARGED

22. The aforesaid acquisition constitutes a violation of Section 7 of the Clayton Act, as amended, and Section 5 of the Federal Trade Commission Act, as amended.

Decision and Order

The Federal Trade Commission, having initiated an investigation of the acquisition of Calma Company (hereinafter "Calma"), by

General Electric Company (hereinafter "GE"), and GE having been furnished thereafter with a copy of a draft of complaint which the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge GE with violations of the Federal Trade Commission Act and the Clayton Act; and

GE, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by GE of all the jurisdictional facts set forth in the aforesaid draft of complaint and the relevant line of commerce, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by GE that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that GE has violated the said Acts, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. GE is a corporation organized, existing and doing businss under and by virtue of the laws of the State of New York with executive offices located at 3135 Easton Turnpike, Fairfield, Connecticut.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of GE, and the proceeding is in the public interest.

Order

I.

It is ordered, That for the purposes of this order the following definitions shall apply:

1. *GE* means General Electric Company, a corporation organized, existing, and doing business under and by virtue of the laws of the State of New York, with its offices at 3135 Easton Turnpike, Fairfield, Connecticut, as well as its directors, officers, employees, agents, its divisions, subsidiaries, controlled affiliates, successors,

assigns, and the directors, officers, employees, or agents of GE's divisions, subsidiaries, affiliates, successors, or assigns.

2. *Calma* means Calma Company, a wholly-owned subsidiary of United Telecommunications, Inc., and a corporation organized, existing, and doing business under and by virtue of the laws of the State of California, with its principal offices at 527 Lakeside Drive, Sunnyvale, California, as well as its directors, officers, employees, agents, its divisions, subsidiaries, successors, assigns, and the directors, officers, employees, or agents of Calma's parents, divisions, subsidiaries, affiliates, successors, or assigns.

3. *Applicon* means Applicon, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Massachusetts, with its principal offices at 32 Second Ave., Burlington, Massachusetts, as well as its directors, officers, employees, agents, its divisions, subsidiaries, successors, assigns, and the directors, officers, employees, or agents of Applicon's divisions, subsidiaries, affiliates, successors, or assigns.

4. *Eligible Person* means any individual, corporation (including subsidiaries thereof), partnership, joint venture, trust, unincorporated association, other business or legal entity, or any combination thereof: (i) acquiring an amount of Applicon's stock that will not result in its ownership or control, directly or indirectly, of 250,000 or more shares of Applicon common stock; or (ii) acquiring Applicon stock on an established stock exchange (other than through a privately negotiated sale which is "crossed" on an exchange) or through a public offering; or (iii) acting as an underwriter for the purpose of reselling such shares pursuant to a secondary public offering.

5. *Initial Divestiture Period* shall mean the period through and including December 31, 1981.

6. *Final Divestiture Period* shall mean the period from the end of the Initial Divestiture Period through and including March 31, 1982.

7. *Documents* means all writings of every kind including, but not limited to, books, records, statements, minutes, reports, studies, memoranda, correspondence, agreements, print-outs, telegrams, diary entries, pamphlets, notes, charts, tabulations, releases, and purchase orders (including any notes, attachments, riders, modifications, etc.) in the possession, custody, or control of GE. The term *documents* also includes voice recordings and reproductions or film impressions of any of the aforementioned writings as well as copies of documents which are not identical duplicates of the orginals and copies of documents the originals of which are not in the possession, custody, or control of the company. The term *documents* further

includes data compilations in machine readable form used in data processing, together with the programming instructions and other written material necessary to understand or use such data compilations.

8. *Relating to* means in whole or in part constituting, containing, embodying, reflecting, identifying, stating, referring to, dealing with, or in any way pertaining to.

9. *CAD/CAM product* means any stand-alone, turnkey, interactive graphics computer aided design/computer aided manufacturing system.

II.

It is further ordered, That:

1. GE shall divest absolutely during the Initial Divestiture Period to Eligible Persons at least two-thirds of the total number of shares of stock in Applicon held by GE either through a secondary public offering, the costs of which are to be borne by GE, through private placement, or according to the provisions of Securities and Exchange Commission Rule 144, 17 C.F.R. 230.144 (1980).

2. GE shall divest absolutely during the Final Divestiture Period, through private placements to Eligible Persons, all the remaining shares of stock in Applicon held by GE, with the exception that no more than 100,000 of such shares may be divested according to the provisions of Securities and Exchange Commission Rule 144, 17 C.F.R. 230.144 (1980).

III.

It is further ordered, That pending the divestiture required under Paragraph II of this order:

1. GE shall not, directly or indirectly, exert any control over or influence or interfere with any of the business decisions, operations or policies of Applicon.

2. No GE officer, employee, representative or agent shall serve in any Applicon position or on Applicon's Board of Directors.

3. GE shall cause its shares of stock in Applicon to be voted *pro-rata* according to the manner in which all other outstanding shares of common stock in Applicon are voted.

4. GE shall not require Applicon to make available or communicate, and shall not seek to obtain or exploit, directly or indirectly, any of Applicon's trade secrets, proprietary or other confidential

business information of any kind, except in the ordinary course of GE's relationship with Applicon in its capacity as a licensor or licensee, lessor or lessee, purchaser or seller of any product, and except as such information may be required under applicable law to be disclosed in selling or disposing of Applicon stock.

IV.

It is further ordered, That:

1. GE shall return to Applicon forthwith upon issuance of this order all non-public documents containing trade secrets or proprietary or other confidential business information received from Applicon:

(a) which were obtained by an officer or employee of GE during such officer or employee's tenure as a director of Applicon;

(b) which were obtained by an officer or employee of GE in connection with discussions with Applicon regarding a possible joint venture;

(c) which, regardless of how obtained, (unless independently obtained by Calma prior to its acquisition by GE) disclose the functions, applications, design or features of any new Applicon product or enhancement to any existing product and the timing of the introduction of any new Applicon product or enhancement to any existing product (except to the extent disclosed in connection with the use or prospective use of Applicon products by GE); Applicon's actual or estimated costs or profit margins; Applicon's research and development plans, projects or expenditures; Applicon's business plans; or any Applicon decision to purchase or produce any component of any existing or new product;

and shall destroy all copies of such documents and all other documents containing Applicon trade secrets or proprietary or other confidential business information, which information was received in the manner described in 1(a) or 1(b) or is of the type described in 1(c).

2. For a period of five years after ceasing to be a director of Applicon no officer or employee of GE who obtained trade secrets, proprietary or confidential information or documents from Applicon during such officer or employee's tenure as a director of Applicon shall:

(a) disclose such information (including to other GE officers or employees);

(b) exert any control over or influence or interfere in any way with the business decisions or operations of Calma;

(c) cause Calma, directly or indirectly, to adopt policies preferred, suggested, or dictated by such director;

(d) cause Calma to change its existing policies or methods of operations;

(e) serve in any Calma position or on Calma's Board of Directors or in any GE position with responsibility for Calma; or

(f) confer, advise, or consult with regard to Calma.

3. Officers and employees of GE who obtained Applicon trade secrets, proprietary, or other confidential business information or documents from any officer or employee of GE who obtained such information or documents during his tenure as a director of Applicon shall keep such information or documents confidential and shall not disclose (including to other GE officers or employees) or make use of such information or documents for five years from the final date of the director's term in office.

4. GE and each of its officers and employees shall keep confidential and not disclose (including to other GE officers or employees) any trade secrets or proprietary or other confidential business information obtained from Applicon during the course of discussions with Applicon regarding a possible joint venture and shall make no use of such information for a period of five years from the date of receipt of the information.

5. Paragraphs IV.3 and IV.4 shall not apply to information which appears in issued patents or printed publications independently available to GE, or which GE can show by written records is in GE's possession through channels independent of Applicon or was independently developed by GE officers or employees without use of information subject to paragraph IV of this order.

6. GE shall forthwith distribute a copy of this order to each of its operating divisions, and to present or future personnel, agents, or representatives having responsibilities relating to the subject matter of paragraphs IV.1 through IV.6, and shall secure from each such person a signed statement acknowledging receipt of such a copy. GE employees subject to paragraphs IV.2, IV.3 and IV.4 shall execute affidavits acknowledging receipt of this order.

V.

It is further ordered, That:

1. For a period of two years following the issuance of this order,

GE shall not adopt, promote, foster, permit, or condone, either formally or informally, any policy with regard to the purchase of any CAD/CAM product which discriminates against Applicon on any basis other than the relative merits of any such product in the application for which it is being purchased, and GE shall, in connection with the purchase of any CAD/CAM product, make its purchase decision based solely on sound business practice which requires using the best sources of supply of products that will provide the greatest total value; that is the best evaluated combination of quality, price, delivery, service and other elements of value.

2. GE shall not enforce its statement of Policy No. 20.11, issued December 7, 1966, entitled "Company Use of General Electric Products," or any amendments to such policy, to the extent that such policy or amendments thereto conflict with the mandate set out in paragraph V.1 of this order.

3. GE shall forthwith and semiannually during the 2-year period following issuance of this order, distribute a copy of this order to each of its officers and employees who are responsible for the purchase of any CAD/CAM product.

VI.

It is further ordered, That periodically, as the Commission shall require during the five years subsequent to the issuance of this order, GE shall submit in writing to the Commission a verified report setting forth in detail the manner and form in which GE intends to comply or has complied with this order.

VII.

It is further ordered, That GE notify the Commission at least thirty (30) days prior to any proposed change in GE such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may effect compliance obligations arising out of this order.

VIII.

It is further ordered, That, for a period of ten years from the date of issuance of this order, GE, its parents, divisions, subsidiaries, affiliates, successors or assigns shall not, directly or indirectly, acquire any stock, share capital or equity interest in, or assets used in the manufacture or sale in or to the U.S. of any CAD/CAM

products by any concern, corporate or non-corporate, engaged in the manufacture or sale of any CAD/CAM products without the prior approval of the Commission.

IN THE MATTER OF

WESTERN GENERAL DAIRIES, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3089. Complaint, May 4, 1982—Decision, May 4, 1982

This consent order requires a Utah dairy cooperative to cease engaging in price discrimination in the sale and distribution of raw milk and dairy products, or communicating in any manner disparaging or derogatory information or opinions concerning competing firms. Commencing one year from its effective date, the order bars the cooperative from restricting, for more than six months, the sale or transfer of "base" by any of its members to any bona fide Grade A milk producer. ("Base" is a member's right to receive from the cooperative the going rate for raw milk.)

Appearances

For the Commission: *David M. Newman* and *Jerome M. Steiner, Jr.*

For the respondent: *Randon W. Wilson, Jones, Waldo, Holbrook & McDonough,* Salt Lake City, Utah.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and of the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Western General Dairies, Inc., an incorporated cooperative association, hereinafter sometimes referred to as respondent, has violated the provisions of said Acts, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Western General Dairies, Inc. is an incorporated cooperative association organized, existing and doing business under and by virtue of the laws of the State of Utah;

Respondent during the period 1973 to 1975 acted as a marketing agent for Federated Dairy Farms, Inc., General Dairies, Inc., and Upper Snake River Valley Dairymen's Association, each an incorporated cooperative association, hereinafter collectively referred to as the "other cooperatives."

Respondent currently owns and operates and for some time last past has owned and operated a number of processing facilities, each

of which was previously owned or used by one of the other cooperatives.

Respondent has had as members in excess of ninety percent of those Grade A producers who were members of the other cooperatives prior to respondent's appointment as marketing agent.

PAR. 2. Respondent is now and for some time last past has been engaged in the sale and distribution of raw milk and dairy products, on its own behalf and on behalf of the other cooperatives, and respondent's members are now and for some time last past have been engaged in the production of raw milk.

PAR. 3. Respondent receives milk from its members who are located in the states of Utah and Idaho.

Respondent sells and distributes or has sold and distributed raw milk to independent processors in the States of Utah, Idaho, Wyoming, and Colorado. Respondent sells and distributes dairy products to wholesale and retail customers in the States of Utah, Wyoming, and Idaho, and to other states in the Western United States.

Respondent operates processing facilities in the States of Utah and Idaho.

There is now and has been at all times mentioned in this Complaint a pattern and course of commerce in respondent's products which is in and affects interstate commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. Except to the extent that competition has been hindered, frustrated, lessened and eliminated as set forth in this Complaint, respondent has been and is in substantial competition with other corporations, cooperative associations, individuals and partnerships engaged in the production, sale and distribution of raw milk and in the manufacture, sale and distribution of dairy products.

PAR. 5. In the course and conduct of its business as above described, respondent has for some time last past effectuated and pursued a policy throughout the states above mentioned, the purpose and effect of which is and has been to monopolize and control the supply of raw milk in those states and to monopolize and control the sale and distribution of dairy products in Utah and Southeastern Idaho.

PAR. 6. By various means and methods, respondent has effectuated and enforced the aforesaid practice and policy. To carry out said practice and policy, respondent adopted and employed the following means and methods among others:

(a) By offering and granting advantageous prices and credit

terms to certain dairy products purchasers which were not offered or granted to other purchasers who compete with them in the resale of such products, it engaged in price discrimination among its purchasers, to the injury of its competitors in the manufacture, sale and distribution of dairy products;

(b) It and its agents, members and employees communicated derogatory information concerning the credit-worthiness of persons, firms, corporations and cooperatives which compete with respondent in the sale and distribution of dairy products;

(c) It has unduly restricted the sale or transfer of base by members desiring to leave the cooperative by conditioning such sale or transfer upon such members' cessation of Grade A milk production.

The above are the means and methods which respondent has used to monopolize and control the supply of raw milk and the sale and distribution of dairy products in the above mentioned states.

PAR. 7. The aforesaid acts and practices have had the capacity, tendency, and effect of hindering, eliminating or suppressing the competition in the production, sale and distribution of raw milk and the sale and distribution of dairy products in the States of Utah and Southeastern Idaho, thus tending to obstruct the free and natural flow of commerce and the freedom of competition in the channels of interstate commerce.

PAR. 8. The acts and practices of respondent, as herein alleged, were and are all to the prejudice of the public and of respondent's competitors and constituted, and now constitute, unfair methods of competition in or affecting commerce or unfair acts and practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act. Certain of the acts and practices of respondent, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

Chairman Miller did not participate.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the San Francisco Regional Office proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act and the Clayton Act; and

The respondent, its attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Western General Dairies, Inc. is an incorporated cooperative association, organized, existing and doing business under and by virtue of the laws of the State of Utah, with its offices and principal place of business located at 195 West 7200 South, in the City of Salt Lake City, State of Utah.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For the purposes of this Order, the following definitions shall apply:

Respondent means Western General Dairies, Inc.

Raw Milk means raw, unprocessed cow's milk.

Dairy products means any products processed from raw milk and includes but is not limited to milk, skim milk, buttermilk, two percent milk, flavored milk, flavored milk drink, filled milk, whipping and table cream, half and half, sour cream, cottage cheese, concentrated milk, fortified milk, reconstituted milk or any mixture in fluid form of milk, skim milk or cream, ice milk, ice cream, powdered milk, butter, yogurt, cheese, or cheese products.

Producer means a person or firm which operates a farm which produces raw milk.

Member means a producer which belongs to or is affiliated with a cooperative association.

Handler means any person, firm, corporation or cooperative association which is considered a handler within any Federal or State Marketing Order.

Processor means a person, firm or corporation, other than a handler, which purchases raw milk.

Base means any right granted or sold by a cooperative association to its members allowing such members to receive from the cooperative the U.S.D.A. Uniform Blend Price or any other established price for any given amount of raw milk.

Grade A means the production of raw milk in compliance with the inspection requirements of a duly constituted health authority for fluid consumption.

I.

It is ordered, That respondent Western General Dairies, Inc., an incorporated cooperative association, its successors and assigns, and its officers, and respondent's agents, representatives, employees, and members, directly or indirectly or through any corporation, cooperative association, subsidiary, division or other device, in connection with the purchasing, offering for sale, sale or distribution of raw milk or dairy products in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

A. Discriminating directly or indirectly in the price of any such product by selling to any customer at a net price higher than the net price charged any other customer who competes in the resale and distribution of such product with the customer paying the higher price. "Net price," as used in this Order, shall mean the ultimate cost to the customer, and for purposes of determining such cost, shall take into account all rebates, allowances, commissions, discounts, credit arrangements, terms and conditions of sale, and other forms of direct and indirect price reductions, by which the ultimate cost to the customer is affected:

B. Furnishing, contracting to furnish or contributing to the furnishing of services or facilities in connection with the handling, sale or offering for sale of any such product to any customer of such product bought for resale, when such services or facilities are not accorded on proportionally equal terms to all other customers who resell such product in competition with any customer who receives such services or facilities;

C. Communicating in any way, whether orally or in writing, any disparaging or derogatory information or opinions concerning any person or firm which competes with respondent in the production or sale of raw milk or dairy products; *provided, however,* that respondent may provide truthful information about such person's or firm's credit relationship with respondent upon written request by (1) a credit reporting agency or (2) any prospective creditor of such person or firm.

II.

It is further ordered, That respondent shall cease and desist from executing or continuing in force any membership contract or agreement with any member which restricts in any way the right of such member to sell raw milk to any person, firm, or association after the expiration of such contract or agreement, except as provided in Section III of this Order.

III.

It is further ordered That, commencing one year after the date of service of this Order, respondent shall cease and desist from restricting the sale or transfer of base by any member in any manner, including but not limited to (1) tying such sale or transfer to the concurrent sale or transfer of land, fixtures, or livestock, or (2) requiring that any member cease, for a period longer than six months, shipping or using raw milk for any Class I utilization, as Class I is defined by the Great Basin Milk Marketing Order;

Provided, however, That respondent may refuse to authorize a sale or transfer of base

(1) to any producer who is not a Grade A producer or who will not become a Grade A producer on or before the date on which such sale or transfer becomes effective;

(2) to any producer who is not a member of respondent or who will not become a member of respondent, on or before the date on which such sale or transfer becomes effective; *provided, however,* that respondent may not refuse to accept a producer as a member in order to bar such a sale or transfer;

(3) to any producer (a) whose location would necessitate a net increase in pickup routes of more than 20 miles; or (b) who would not be able to ship an average of 5000 pounds of milk or more per pickup;

(4) where respondent has not received written notice of such sale

or transfer more than 60 days prior to the date on which such sale or transfer becomes effective.

IV.

It is further ordered, That respondent shall, within sixty (60) days after service upon it of this Order, distribute a copy of this Order to each of its operating divisions and to all officers, employees, agents and members and shall distribute a copy of this Order to any person or firm that becomes a member within five (5) years after service of this Order.

V.

It is further ordered, That respondent herein shall, within sixty (60) days after service upon it of this Order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this Order.

VI.

It is further ordered, That, for a period of ten (10) years after service upon it of this Order, respondent notify the Commission at least thirty (30) days prior to any proposed change in the respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, the appointment of a marketing agent, the transfer of any facility designated as a pool plant under any Federal Milk Marketing Order, or any other change in the respondent which may affect compliance obligations arising out of the Order.

Chairman Miller did not participate.

IN THE MATTER OF

THE AMERICAN MEDICAL ASSOCIATION, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9064. Final Order, Oct. 12, 1979—Modifying Order, May 19, 1982

The FTC, in accordance with a decision and judgment rendered by the Court of Appeals for the Second Circuit on October 7, 1980, has modified its Final Order In the Matter of The American Medical Association, et al. issued on October 12, 1979 (94 F.T.C. 701). The modified order, effective May 19, 1982 narrows the scope of the order so as not to encroach upon the valid activities of the AMA.

MODIFIED ORDER TO CEASE AND DESIST

Respondents having filed in the United States Court of Appeals for the Second Circuit a petition for review of the Commission's cease and desist order issued herein on October 12, 1979; and the Court having rendered its decision and judgment on October 7, 1980, affirming and enforcing the Commission's order with modification of Parts I and II; and the Supreme Court of the United States having affirmed by an equally divided court the judgment of the court of appeals on March 23, 1982, and having denied a petition for rehearing on May 3, 1982:

Now, therefore, it is hereby ordered, That the aforesaid order to cease and desist be, and it hereby is, modified in accordance with the decision and judgment of the Court of Appeals to read as follows:

ORDER

I.

It is ordered, That respondent American Medical Association, and its delegates, trustees, councils, committees, officers, representatives, agents, employees, successors and assigns, directly or indirectly, or through any corporate or other device, in or in connection with respondent's activities as a professional association in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Restricting, regulating, impeding, declaring unethical, interfering with, or advising against the advertising or publishing by any person of the prices, terms or conditions of sale of physicians' services, or of information about physicians' services, facilities or

equipment which are offered for sale or made available by physicians or by any organization with which physicians are affiliated;

B. Restricting, regulating, impeding, declaring unethical, interfering with, or advising against the solicitation, through advertising or by any other means, including but not limited to bidding practices, of patients, patronage, or contracts to supply physicians' services, by any physician or by any organization with which physicians are affiliated; and

C. Inducing, urging, encouraging, or assisting any physician, or any medical association, group of physicians, hospital, insurance carrier or any other non-governmental organization to take any of the actions prohibited by this Part.

Nothing contained in this Part shall prohibit respondent from formulating, adopting, disseminating to its constituent and component medical organizations and to its members, and enforcing reasonable ethical guidelines governing the conduct of its members with respect to representations, including unsubstantiated representations, that respondent reasonably believes would be false or deceptive within the meaning of Section 5 of the Federal Trade Commission Act, or with respect to uninvited, in-person solicitation of actual or potential patients, who, because of their particular circumstances, are vulnerable to undue influence.

II.

It is further ordered, That respondent American Medical Association, and its delegates, trustees, councils, committees, officers, representatives, agents, employees, successors and assigns, directly or indirectly, or through any corporate or other device, in or in connection with respondent's activities as a professional association in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Restricting, regulating, impeding, advising on the ethical propriety of, or interfering with the consideration offered or provided to any physician in any contract with any entity that offers physicians' services to the public, in return for the sale, purchase or distribution of his or her professional services, except for professional peer review of fee practices of physicians;

B. Restricting, interfering with, or impeding the growth, development or operations of any entity that offers physicians' services to the public, by means of any statement or other representation concerning the ethical propriety of medical service arrangements that limit the patient's choice of a physician;

C. Restricitng, interfering with, or impeding the growth, development or operations of any entity that offers physicians' services to the public, by means of any statement or other representation concerning the ethical propriety of participation by non-physicians in the ownership or management of said organization; and

D. Inducing, urging, encouraging, or assisting any physician, or any medical association, group of physicians, hospital, insurance carrier or any other non-governmental organization to take any of the actions prohibited by this Part.

III.

It is further ordered, That respondent American Medical Association cease and desist from taking any formal action against a person alleged to have violated any ethical standard promulgated in conformity with this Order without first providing such person with:

A. Reasonable written notice of the allegations against him or her;

B. A hearing wherein such person or a person retained by him or her may seek to rebut such allegations; and

C. The written findings or conclusions of respondent with respect to such allegations.

IV.

It is further ordered, That respondent American Medical Association:

A. Send by first class mail a copy of a letter in the form shown in Appendix A to this Order to each of its present members and to each constituent and component organization of respondent, within sixty (60) days after this Order becomes final.

B. For a period of ten years, provide each new member of respondent and each constituent and component organization of respondent with a copy of this Order at the time the member is accepted into membership.

C. Within ninety (90) days after this Order becomes final, remove from respondent American Medical Association's *Principles of Medical Ethics* and the Judicial Council's *Opinions and Reports,* and from the constitution and bylaws and any other existing policy statement or guideline of respondent, any provision, interpretation or policy statement which is inconsistent with the provisions of Parts I and II of this Order and, within one hundred and twenty (120) days

after this Order becomes final, publish in the *Journal of the American Medical Association* and in *American Medical News* the revised versions of such documents, statements, or guidelines.

D. Require as a condition of affiliation with respondent that any constituent or component organization agree by action taken by the constituent or component organization's governing body to adhere to the provisions of Parts I, II, and III of this Order.

E. Terminate for a period of one year their affiliation with any constituent or component organization within one hundred and twenty (120) days after learning or having reason to believe that said constituent or component organization has engaged, after the date this Order becomes final, in any act or practice that if committed by respondent would be prohibited by Part I, II, or III of this Order.

V.

It is further ordered, That respondent American Medical Association:

A. Within sixty (60) days after the Order becomes final publish a copy of this Order with such prominence as feature articles are regularly published in the *Journal of the American Medical Association* and in *American Medical News* or in any successor publications.

B. Within one hundred and twenty (120) days after this Order becomes final, file a written report with the Federal Trade Commission setting forth in detail the manner and form in which it has complied with this Order.

C. For a period of five (5) years after this Order becomes final, maintain and make available to the Commission staff for inspection and copying upon reasonable notice, records adequate to describe in detail any action taken in connection with the activities covered by Parts I and II of this Order, including but not limited to any advice or interpretations rendered with respect to advertising, solicitation, or contract practice involving any of its members.

D. Within one year after this Order becomes final, and annually thereafter, for a period of five (5) years, file a written report with the Federal Trade Commission setting forth in detail any action taken in connection with the activities covered by Parts I and II of this Order, including but not limited to any advice or interpretations rendered with respect to advertising, solicitation or contract practice involving any of its members.

VI.

It is further ordered, That respondent American Medical Association shall notify the Commission at least thirty (30) days prior to any proposed change in the respondent, such as dissoluton, assignment, or sale resulting in the emergence of a successor corporation or association, or any other change in the corporation or association which may affect compliance obligations arising out of this Order.

Appendix A

Dear Doctor:

As you know, the Federal Trade Commission issued a complaint against the AMA on December 19, 1975, challenging the AMA's ethical restrictions on the advertising, solicitation, and contractual practices of its members. The complaint also named the Connecticut State Medical Society and the New Haven County Medical Association, Inc., as respondents.

In an opinion issued on [insert issue date], the FTC held that the AMA, the two Connecticut medical societies, and other state and local medical associations have unlawfully restricted the advertising, solicitation, and contractual practices of their members in violation of Section 5 of the Federal Trade Commission Act.

In conjunction with that opinion, the Commission issued an order which has not become final. This order is printed in the [insert issue date] issue of the *Journal of the American Medical Association,* the [insert issue date] issue of *American Medical News* and may be obtained from the AMA headquarters or from your state or local medical society.

Among other things, the order forbids any action by AMA that would:

–Restrict its members' solicitation of patients by advertising, submission of bids, or other means.

–Interfere with either the amount or the form of compensation provided a member in exchange for his or her professional services, in contracts with entities offering physician services to the public.

–Characterize as unethical the use of closed panel or other health care delivery plans that limit the patient's choice of a physician.

–Characterize as unethical the participation of non-physicians in the ownership or management of health care organizations that provide physician services to the public.

However, the order does not prohibit the AMA from formulating and enforcing reasonable ethical guidelines governing deceptive advertising and solicitation (including unsubstantiated representations). The AMA may also issue guidelines concerning uninvited, in-person solicitation of patients who, because of their particular circumstances, are vulnerable to undue influence.

Finally, the order requires the AMA to amend the *Principles of Medical Ethics* and

the Judicial Council's *Opinions and Reports* and to sever all ties for one year with any state or local medical society that engages in conduct of the type prohibited under the order.

Thank you for your cooperation.

Sincerely,

President

IN THE MATTER OF

VOLKSWAGEN OF AMERICA, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3090. Complaint, May 24, 1982—Decision, May 24, 1982

This consent order requires, among other things, a Warren, Mich. producer and seller of motor vehicles and replacement parts to cease including in owners' manuals for diesel motor vehicles any instructions for oil filter installation that differs from that provided to its dealers. Respondent is required to include in future maintenence manuals a conspicuous statement warning of the need to follow oil filter installation instructions carefully to avoid serious engine damage. Further, the firm is required to reimburse current and past owners of 1977–1981 Volkswagen and Audi diesels for repairs which resulted from oil filter leaks; notify these owners of the reimbursement offer by first class mail; and provide them with currently recommended oil filter installation information. Additionally, respondent is required to locate and pay reimbursement to eligible owners in a timely manner and maintain specified records for a period of three years.

Appearances

For the Commission: *Stephen H. Meyer.*

For the respondent: *N. Richard Skipper, Jr.,* in-house counsel, Warren, Mich. and *Gerhard P. Riechel,* in-house counsel, Englewood Cliffs, N.J.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Volkswagen of America, Inc., a corporation subject to the Commission's jurisdiction, hereinafter sometimes referred to as respondent VWoA, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Volkswagen of America, Inc., is a corporation organized, existing, and doing business under and by virtue of the laws of the State of New Jersey with its principal office and place of business located at 27621 Parkview Road, Warren, Michigan.

PAR. 2. Respondent VWoA is now and has been engaged in the

production, distribution, offering for sale or sale of vehicles or vehicle parts.

PAR. 3. Respondent VWoA maintains and has maintained a substantial course of business, including the acts and practices alleged in this complaint, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. An abnormally high number of Volkswagen and Audi vehicles sold in the United States beginning in the 1977 model year and equipped with diesel engines have experienced, are experiencing, or are likely to experience oil filter leaks. Such oil filter leaks have caused engine problems and engine failures resulting from lack of lubricating oil which are costly to correct or may significantly affect the quality, reliability, durability, or performance of the vehicles.

PAR. 5. Respondent knew or should have known that the oil filter leaks described in Paragraph Four above have occurred in abnormally high numbers.

PAR. 6. Respondent stated the following as part of the recommended oil filter installation procedure in its owner's manuals for its 1977 and 1978 model year vehicles equipped with diesel engines:

Tighten new filter by hand as tightly as possible. Do not use a wrench to tighten filter.

PAR. 7. Respondent stated the following as part of the recommended oil filter installation procedure in its owner's manuals for its 1979 and 1980 model year vehicles equipped with diesel engines:

Only hand-tighten according to filter manufacturer's instructions on the carton or on the filter element.

PAR. 8. Respondent has notified its dealers about oil filter leaks on its vehicles equipped with diesel engines and, to reduce the likelihood of oil filter leaks, has sent revised oil filter installation instructions for vehicles equipped with diesel engines to its dealers. The revised installation instructions, which prescribe precise installation procedures using specified wrenches, contradict directions contained in the owner's manuals for the 1977–1980 model year vehicles equipped with diesel engines.

PAR. 9. Respondent has failed and is failing to disclose to owners of 1977–1980 Volkswagen and Audi vehicles equipped with diesel engines the following facts:

1. the likelihood of oil filter leaks on its diesel engines,

2. the revised installation instructions described in Paragraph Eight, and

3. the reduced likelihood of oil filter leaks if the revised installation instructions are carefully followed.

These facts relate to the existence, nature, extent, or prevention of oil filter leaks on diesel vehicles.

PAR. 10. The facts described in Paragraph Nine above are material to many owners because such facts, if known, would be likely to affect their decisions concerning the maintenance, repair, use or care of Volkswagen and Audi vehicles.

PAR. 11. Respondent has failed and is failing to disclose material facts to owners of Volkswagen and Audi vehicles.

PAR. 12. The acts and practices of respondent in failing to disclose material facts have had and continue to have the capacity and the tendency to mislead many members of the public, particularly those who own Volkswagen and Audi vehicles.

PAR. 13. The acts and practices of respondent also have caused or continue to cause substantial economic harm to many members of the public who have paid or continue to pay for engine repairs which they might not otherwise have purchased if respondents had adequately disclosed such material facts.

PAR. 14. The acts and practices of respondent has caused or continues to cause substantial economic harm to many members of the public who do not take preventive measures which they might take if such material facts were adequately disclosed.

PAR. 15. The acts and practices of respondent in failing to disclose material facts as alleged herein were and are all to the prejudice and injury of the public and of respondent's competitors and constituted, and now constitute, unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce, in violation of Section 5 of the Federal Trade Commission Act, as amended.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the

signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it has reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comments filed thereafter by interested persons pursuant to Section 2.34 of its Rules, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Volkswagen of America, Inc. is a corporation organized, existing and doing business under and by virture of the laws of the State of New Jersey, with its office and pricipal place of business located at 27621 Parkview Road, in the City of Warren, State of Michigan.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

For purposes of this order, the following definitions shall apply:

1. *Dealer* shall mean any authorized United States Volkswagen or Audi dealer regardless of whether the dealer purchases vehicles directly from respondent or from a distributor of respondent.

2. *Owner* shall mean any individual or entity in whose name a vehicle is currently or has been previously registered or titled with the appropriate state authority, including, but not limited to, vehicles held for resale.

3. *Current owner* shall mean any owner in whose name a vehicle is registered or titled with the appropriate state authority. Respondent shall use any one or more of the following methods to obtain the most up to date and complete list available of the names and addresses of current owners in carrying out it obligations under Parts I and III of this Order: state records, a commercial locator service, or respondent's records. If the name and address of the current owner cannot be ascertained, then *current owner* shall also

mean the most recent purchaser known to respondent, respondent's dealers, or both.

4. *Engine repairs due to oil filter leaks* shall consist of expenses necessitated by an oil filter leak for engine repair or engine replacement, plus towing charges, oil and oil filter replacement. It does not include reimbursement for towing charges, oil, and replacement oil filter(s) if no engine repair or engine replacement was undertaken.

5. *oil filter leak(s)* shall mean any leakage of lubricating oil from the oil filter or from the area where the oil filter is attached to the engine.

PART I

It is ordered, That respondent Volkswagen of America, Inc., a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or indirectly or through any corporation, subsidiary, division, or other device, in connection with the manufacturer, advertising, offering for sale, sale or distribution of any vehicle or vehicle part, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from representing in any owner's manual for its diesel engine vehicles an oil filter installation procedure that is different in substance from that provided to its dealers with respect to vehicles covered by such manual, unless respondent notifies affected current owners via first class mail that the installation procedure set out in their owner's manuals is different in substance from that provided to respondent's dealers and in what respects the instructions differ.

PART II

It is further ordered, That respondent Volkswagen of America, Inc., a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or indirectly or through any corporation, subsidiary, division, or other device, in connection with the manufacture, advertising, offering for sale, sale or distribution of any vehicle or vehicle part, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, shall:

A. Include, verbatim, using distinctive and conspicuous type face or ink color or both, which shall be at least as distinctive and conspicuous as the type face or ink color or both used elsewhere in owner's manuals for important maintenance items, the following

statement in owner's manuals of Volkswagen and Audi vehicles with diesel engines beginning in the 1982 model year:

FOLLOW THESE INSTRUCTIONS CAREFULLY. AN IMPROPERLY INSTALLED FILTER MAY LEAK AND DAMAGE YOUR ENGINE.

B. Beginning 30 days following the date this order is served on respondent, print clearly and conspicuously on all oil filters which are sold by respondent and which are recommended for application on respondent's diesel engine vehicles:

1. the most current installation instructions; and
2. the following statement, verbatim:

IMPORTANT: FOLLOW THESE INSTRUCTIONS CAREFULLY. AN IMPROPERLY INSTALLED FILTER MAY LEAK AND DAMAGE YOUR ENGINE.

C. Disseminate, by respondent's usual methods, within 30 days following the date this order is served upon respondent, a Product Circular to Volkswagen and Audi dealers which effectively communicates the following:

1. that oil filter leaks on diesel engines have occurred; and
2. that mechanics should be sure to install the filters according to the most current procedures.

PART III

It is further ordered, That respondent, within 30 days following the service of this order on respondent, shall:

A. Send by first class mail to each current owner of a 1977 through 1981 model year Volkswagen and Audi vehicle equipped with a diesel engine a copy of Exhibits A, B and E and a postage-paid self-addressed return envelope.

B. Send by first-class mail a copy of Exhibits B, C and E and a postage-paid self-addressed return envolope to any owner of a 1977 through 1981 model year Volkswagen or Audi vehicle equipped with a diesel engine who requests information concerning reimbursement for oil filter leaks.

C. Search its warranty and complaint records and those of its distributors to ascertain the names and addresses of owners who had previously complained about and not received full reimbursement for engine repairs due to oil filter leaks on diesel engines. Owners whose names appear on any such records shall be sent by first class mail Exhibits B, D1, and E and a postage-paid self-addressed return

envelope; *provided, however,* that where records clearly establish an owner's entitlement to and amount of reimbursement under Part IV of this order, respondent shall send a check for such amount and Exhibits D2, B, and E.

PART IV

It is further ordered, That respondent:

A. Provide reimbursement to each owner of a 1977 through 1981 model year Volkswagen or Audi vehicle equipped with a diesel engine who has unreimbursed expenses for engine repairs due to an oil filter leak, which occurred prior to 30 days after the owner's receipt of a letter sent pursuant to Parts III A, B or C of the order or 60 days after the date of mailing of such letter, whichever comes first; *provided, however,* that respondent need not reimburse an owner for an engine repair due to an oil filter leak if the oil filter on the vehicle at the time of the leak had not been distributed by respondent, unless the leak was proximately caused by a Volkswagen or Audi original equipment or replacement part for which repair or replacement was necessary; *provided, further, however* that respondent may deny reimbursement to owners whose initial request in writing for reimbursement is received more than two (2) years after the date this order is served upon respondent or more than six (6) months after the owner has received a letter pursuant to Part III A, B, or C of this order, whichever comes first.

B. Shall pay full reimbursement for engine repairs due to an oil filter leak upon presentation by an owner of reasonable evidence that the owner is eligible for reimbursement pursuant to Part IV A above; *provided, however,* respondent may perform a documented inquiry concerning a claim if it believes for good cause that the owner may not be eligible to receive the amount claimed by the owner. Such an inquiry must begin and any request that an owner provide further information must be sent within 30 days after the owner has mailed a copy of Exhibit B to respondent or otherwise requested reimbursement in writing.

C. Shall within the 30 days set out in Part IV B mail to the owner a check for the amount claimed by the owner unless:

1. respondent both begins an inquiry and notifies the owner in writing that an inquiry is being conducted; or

2. respondent denies reimbursement for some or all of the amount claimed by the owner, and sends the owner a letter pursuant to Part IV F, below.

D. Shall complete each inquiry conducted pursuant to Part IV B:

1. within sixty (60) days after the owner has mailed a copy of Exhibit B to respondent or otherwise requested reimbursement in writing; or

2. within thirty (30) days following the mailing to respondent of any response to a request for additional information sent to an owner as part of an inquiry conducted pursuant to Part IV B,

whichever is later.

E. Shall, upon completion of each inquiry, send the owner a check, a letter pursuant to Part IV F, or both.

F. Shall send a letter by first class mail to each owner who has been denied reimbursement for some or all of the amount claimed by the owner. This letter shall:

1. notify the owner of the disposition of the claim;

2. give specific reasons for the disposition;

3. inform the owner that he/she may have other legal rights;

4. if available in the area where the owner lives, inform the owner of the existence of the Better Business Bureau Arbitration program and the following:

a. that the program is operated free of charge to the owner;

b. that by choosing arbitration both parties may give up the right to have the facts of the dispute decided in court;

c. that the arbitrator's decision is binding and may be enforced in court;

d. that the arbitrator's decision can be appealed only for limited reasons; and

e. that owners who want more information should contact their local Better Business Bureau; and

5. inform the owner that the oil filter reimbursement program is being conducted by agreement between Volkswagen of America and the Federal Trade Commission, and that if he/she believes his claim was improperly denied he/she may contact the FTC's Compliance Division of the Bureau of Consumer Protection at 6th and Pennsylvania Avenue, N.W., Washington, D.C. 20580.

PART V

It is further ordered, That respondent shall maintain accurately and retain for a period of three (3) years following the service of this

order on respondent the following records which may be inspected by Commission staff members upon fifteen (15) days' notice:

1. a list, by state and, for each state, in alphabetical order, (or a data base from which such list may be readily compiled) containing the names and addresses of each owner of a Volkswagen and Audi vehicle to whom Exhibits A–E were sent and the dates such letters were sent to each;

2. a list, by state and, for each state, in alphabetical order, containing the name and address of each owner of a Volkswagen or Audi vehicle who received a check pursuant to Part IV C and each owner who requested reimbursement from respondent pursuant to Exhibit B or another writing and, for each, the date such request was received by respondent, the total dollar amount of such request. Respondent shall also maintain all documents initially submitted by owners and each of the following as applicable to such owner: documents indicating whether follow-up information was requested and the date such information was requested; all additional information submitted in response to any request for follow-up information and the date such information was received; documents relating to any inquiry by respondent of the circumstances surrounding such owner's claim; all documents indicating the total dollar amount of reimbursement, if any, such owner was sent, the date it was sent, and a copy of the notice of final disposition of the claim, if sent to such owner.

PART VI

It is further ordered, That any and all correspondence sent by respondent pursuant to the provisions of this order shall be on respondent's corporate stationery. All envelopes sent pursuant to Part III shall contain no marking other than respondent's name and return address, the postage marking, the name and address of the addressee, and the words "IMPORTANT MAINTENANCE AND REIMBURSEMENT INFORMATION" disclosed conspicuously on the front.

PART VII

It is further ordered, That respondent shall send a copy of this order to each of its dealers.

PART VIII

It is further ordered, That no provision of this order shall be construed to limit, in any way, any private right of action which any individual, partnership, corporation or other entity might have against respondent or against any oil filter manufacturer.

PART IX

It is further ordered, That the respondent shall forthwith distribute a copy of this order to each of its operating divisions, to its successors and assigns.

PART X

It is further ordered, That for so long as any other provisions of this order remain in effect respondent notify the Commission at least thirty (30) days prior to the effective date of any proposed change in the respondent such as dissolution, assignment or sale, resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation which may affect compliance obligations arising out of the order.

PART XI

It is further ordered, That respondent shall within sixty (60) days after service upon it of the order, and also annually for two (2) years thereafter, file with the Commission reports in writing, setting forth in detail the manner and form in which it has complied with this order.

PART XII

It is further ordered, That Parts I and II A and B of the order shall terminate at any time if,

1. respondent's oil filter installation instructions do not provide for any wrenches or special tools to tighten the filter, and

2. respondent possesses competent and reliable engineering evidence which substantiates that the installation of the oil filter without the use of wrenches or special tools under normal field conditions would be substantially as effective in preventing oil filter leaks as installation of the filter with wrenches or special tools.

EXHIBIT A

IMPORTANT MAINTENANCE AND REIMBURSEMENT INFORMATION

Dear [Volkswagen] [Audi] Diesel Owner:

Some [Volkswagen] [Audi] diesel owners have reported oil leaks in the oil filter area of the engine. On occasion, this can lead to severe engine damage. Therefore, we'd like to tell you some important news about:

•new recommendations for oil filter installation procedures which can help prevent oil filter leak problems, and
•our reimbursement offer for past problems and warranty coverage for future problems like this.

INSTALLATION INSTRUCTIONS

We've modified the diesel oil filter instructions to emphasize that the filter must be properly mounted and tightened. You or the mechanic must follow these instructions carefully to guard against oil leaks. Use the correct tools to tighten the filter and check the mounting torque. These new instructions are enclosed. *Please staple them to the cover of your owner's manual and make sure they are followed each time an oil filter is installed.*

REIMBURSEMENT OFFER

If you paid for engine repairs caused by an oil leak in the filter area, and were not reimbursed, and the filter was an Autobahn (VW/Audi) filter, we'll reimburse you for engine repairs, oil, filter, and towing. If the filter was not a VW/Audi/Autobahn filter, we'll pay for repairs only if a VW/Audi engine part that had to be repaired or replaced caused the problem. This offer covers engine repairs which occured prior to or within 30 days after you receive this letter. If our coverage doesn't apply to engine repairs you paid for, check to see if the filter manufacturer will reimburse you for expenses.

Don't forget that your car's warranty may also provide coverage for these and other repair problems in the future. The "new vehicle limited warranty" covers defects in materials and workmanship for [12 months or 20,000 miles, whichever comes first (VW)]. [12 months, regardless of mileage (Audi)]. The "replacement parts limited warranty" covers such defects for six months or 6,000 miles.

COMPLETE THE ENCLOSED FORM

If you believe you may be entitled to reimbursement under this program, complete the enclosed form and send it to us. *Even if you were previously denied warranty service or if you aren't sure you're eligible, send in the form.* Within 30 days, we'll send you a check or contact you with information about the status of your claim.

You must send in your form within six months after you receive this letter to qualify for the reimbursement offer. If you have any questions, don't hestitate to contact us or your local dealer.

Sincerely,

Volkswagen of America, Inc.

Exhibit B

REIMBURSEMENT REQUEST ENGINE REPAIR
DUE TO DIESEL OIL FILTER LEAK

INSTRUCTIONS: *Make sure you follow these instructions carefully.* If we don't have enough information your claim might be delayed.

Attach to this form legible copies of all the documents you have which support your claim including receipts, repair orders, cancelled checks or money orders. If you don't have a repair order, get a short statement from the garage or dealership where the repair was done which tells us what work was done, and why.

We will reimburse you for engine repairs, oil, a new oil filter, and towing if you qualify for reimbursement. We will *not* reimburse you if your only damage was loss of oil and towing.

Name _____ VIN _____ [Preprinted] _____

City _____ State _____

Zip Code _____ Phone ( ) _____

Total Amount Actually Paid: $_____

Brand of Filter _____

To the best of my knowledge, the above claim is for expenses I had to pay for which I was not reimbursed and which resulted from an oil leak from my car's oil filter.

I hereby certify that the above information is true and correct.

_____ _____

Date Signature

BE SURE TO ENCLOSE ALL YOUR PROOF WHEN YOU MAIL US THIS FORM!

Exhibit C

IMPORTANT MAINTENANCE AND
REIMBURSEMENT INFORMATION

Dear [Volkswagen] [Audi] Diesel Owner:

Thank you for contacting us about oil filter leaks on our diesel engines. Some [Volkswagen] [Audi] diesel owners have reported oil leaks in the oil filter area of the engine. On occasion, this can lead to severe engine damage. Therefore, we'd like to tell you some important news about:

*new recommendations for oil filter installation procedures which can help prevent oil filter leak problems, and
*our reimbursement offer for past problems and warranty coverage for future problems like this.

INSTALLATION INSTRUCTIONS

We've modified the diesel oil filter instructions to emphasize that the filter must be properly mounted and tightened. You or the mechanic must follow these instructions carefully to guard against oil leaks. Use the correct tools to tighten the filter and

check the mounting torque. These new instructions are enclosed. *Please staple them to the cover of your owner's manual and make sure they are followed each time an oil filter is installed.*

REIMBURSEMENT OFFER

If you paid for engine repairs caused by an oil leak in the filter area, and were not reimbursed, and if the filter was an Autobahn (VW/Audi) filter, we'll reimburse you for engine repairs, oil, filter, and towing. If the filter was not a VW/Audi/Autobahn filter, we'll pay for repairs only if a VW/Audi engine part that had to be replaced caused the problem. This offer covers engine repairs which occured prior to or within 30 days after you receive this letter. If our coverage doesn't apply to engine repairs you paid for, check to see if the filter manufacturer will reimburse you for expenses.

Don't forget that your car's warranty may also provide coverage for these and other repair problems in the future. The "new vehicle limited warranty" covers defects in materials and workmanship for [12 months or 20,000 miles, whichever comes first (VW)]. [12 months, regardless of mileage (Audi)]. The "replacement parts limited warranty" covers such defects for six months or 6,000 miles.

COMPLETE THE ENCLOSED FORM

If you believe you may be entitled to reimbursement under this program, complete the enclosed form and send it to us. *Even if you were previously denied warranty service or if you aren't sure you're eligible, send in the form.* Within 30 days, we'll send you a check or contact you with information about the status of your claim.

You must send in your form within six months after you receive this letter to qualify for this reimbursement offer. If you have any questions, don't hesitate to contact us or your local dealer.

Sincerely,

Volkswagen of America, Inc.

Exhibit D1

IMPORTANT MAINTENANCE AND
REIMBURSEMENT INFORMATION

Dear [Volkswagen] [Audi] Diesel Owner:

Our records show that your car has experienced an oil filter leak. As you may know, on occasion, this can lead to severe engine damage. Therefore, we'd like to tell you some important news about:

*new recommendations for oil filter installation procedures which can help prevent oil filter leak problems, and
*our reimbursement offer for past problems and warranty coverage for future problems like this.

INSTALLATION INSTRUCTIONS

We've modified the diesel oil filter instructions to emphasize that the filter must be

properly mounted and tightened. You or the mechanic must follow these instructions carefully to guard against oil leaks. Use the correct tools to tighten the filter and check the mounting torque. These new instructions are enclosed. *Please staple them to the cover of your owner's manual and make sure they are followed each time an oil filter is installed.*

REIMBURSEMENT OFFER

If you paid for engine repairs caused by an oil leak in the filter area, and were not reimbursed, and the filter was an Autobahn (VW/Audi) filter, we'll reimburse you for engine repairs, oil, filter, and towing. If the filter was not a VW/Audi/Autobahn filter, we'll pay for repairs only if a VW/Audi engine part that had to be replaced caused the problem. This offer covers engine repairs which occured prior to or within 30 days after you receive this letter. If our coverage doesn't apply to engine repairs you paid for, check to see if the filter manufacturer will reimburse you for expenses.

Don't forget that your car's warranty may also provide coverage for these and other repair problems in the future. The "new vehicle limited warranty" covers defects in materials and workmanship for [12 months or 20,000 miles, whichever comes first (VW)]. [12 months, regardless of mileage (Audi)]. The "replacement parts limited warranty" covers such defects for six months or 6,000 miles.

COMPLETE THE ENCLOSED FORM

If you believe you may be entitled to reimbursement under this program, complete the enclosed form and send it to us. *Even if you were previously denied warranty service or if you aren't sure you're eligible, send in the form.* Within 30 days, we'll send you a check or contact you with information about the status of your claim.

You must send in your form within six months after you receive this letter to qualify for this reimbursement offer. If you have any questions, don't hestitate to contact us or your local dealer.

Sincerely,

Volkswagen of America, Inc.

Exhibit D2

IMPORTANT
REIMBURSEMENT CHECK ENCLOSED

Dear [Volkswagen] [Audi] Diesel Owner:

Our records show that you experienced engine damage related to an oil filter leak on your [Volkswagen] [Audi] diesel vehicle and that reimbursement for your repair costs was not made available in your case.

We have recently reconsidered your claim. On the basis of our review, we have determined that reimbursement was appropriate and should have been granted.

Accordingly, we are pleased to enclose our check in the amount of $ _____ . We regret the delay. However, we are pleased that we were able to be of assistance.

If this amount is less than what you paid for engine repairs due to an oil filter leak, oil, a new oil filter, and towing, fill out the attached form and return it to us in the enclosed postage-paid envelope. Even if you request additional reimbursement, you

can still cash this check. Within 30 days, we'll send you an additonal check or contact you with information about the status of your claim.

If you do request additional reimbursement under this offer, you must send in your form within 6 months after you receive this letter. If you have any questions, don't hestitate to contact us or your local dealer.

INSTALLATION INSTRUCTIONS

We've modified the diesel oil filter instructions to emphasize that the filter must be properly mounted and tightened. You or the mechanic must follow these instructions carefully to guard against oil leaks. Use the correct tools to tighten the filter and check the mounting torque. These new instructions are enclosed. *Please staple them to the cover of your owner's manual and make sure they are followed each time an oil filter is installed.*

Sincerely,

Volkswagen of America, Inc.

Exhibit E

OIL FILTER INSTALLATION INSTRUCTIONS

1. Use VW Part No. 068 115 561 or equivalent. [For Owner's Manual and Exhibit E only]
2. Apply thin film of engine oil to filter gasket. (Do not use grease.)
3. Screw on filter by hand until filter gasket contacts flange firmly all round.
4. Tighten filter 3/4 turn. Use VW filter cap wrench US–4496 or equivalent, wrench extension, and standard torque wrench.
5. Check dipstick for correct oil level.
6. Run engine at various speeds for 3–5 minutes.
7. Stop engine, use filter cap wrench (center drive socket), extension and torque wrench for final check. Torque must be at least 18 ft. lbs.
8. Re-check dipstick for correct oil level, add oil as needed.
9. Start engine and check for proper seal at the oil filter gasket.

IMPORTANT: FOLLOW THESE INSTRUCTIONS CAREFULLY. AN IMPROPERLY INSTALLED FILTER MAY LEAK AND DAMAGE YOUR ENGINE. [Figure 17–A14 from 1981 Rabbit Owner's Manual, P.93]

IN THE MATTER OF

WEYERHAEUSER COMPANY, ET AL.

Docket 9150. Interlocutory Order, June 10, 1982

ORDER DENYING MOTION OF WEYERHAEUSER COMPANY FOR LEAVE TO FILE REPLY MEMORANDUM

On April 21, 1982, Weyerhaeuser Company filed an application under Rule 3.23(b) of the Commission's Rules of Practice for review of a discovery order of the ALJ. On April 30, complaint counsel filed an answer. Weyerhaeuser has now requested the opportunity to file a reply memorandum because: (1) its application for review was only three pages (although the Rules allow for fifteen) and did not summarize the company's position, whereas complaint counsel used eight pages and did summarize their position, and (2) "complaint counsel's response misperceives the nature of the review sought."

Weyerhaeuser has not offered sufficient reason for the Commission to deviate from its Rules in this instance and allow for an additional filing. Interlocutory appeals of ALJ orders are entertained only in a narrow set of circumstances, and only after full consideration of all the issues by the ALJ. To allow otherwise would involve the Commission unduly in adjudicative proceedings and undermine the authority of its ALJ's. Consequently, the Rules allow the parties each one short, prompt filing. Weyerhaeuser's application for review was shorter than required; that was its decision.

In an interlocutory appeal, the Commission is concerned with the issues as they were briefed to and decided by the ALJ. There is little need for additional argument, unless one of the parties claims that the *ALJ* misperceived the issues before him. Even in such cases, the Rules provide adequate opportunity for argument in most instances.

Weyerhaeuser's motion is hereby denied.

IN THE MATTER OF

WEYERHAEUSER COMPANY, ET AL.

Docket 9150. Interlocutory Order, June 17, 1982

ORDER DENYING RESPONDENTS' APPEAL OF THE ALJ'S RULING OF JANUARY 6, 1982

On January 6, 1982, the ALJ granted complaint counsel's motion to exclude discovery in this case on any beneficial effects on either the community of North Bend, Oregon or the nation's balance of payments of the acquisition by Weyerhaeuser Company of Menasha Corporation's corrugated medium mill and adjacent mill site in North Bend. At the same time, the ALJ expressed a willingness to consider the admission of evidence on the effects of the acquisition on employment in North Bend, but only as it would pertain to the selection of a remedy in the case.

We agree with the ALJ that "[e]vidence regarding the alleged beneficial effects of the merger on the community of North Bend, Oregon and on the nation's balance of payments is extraneous to the determination of whether this merger constitutes a violation of either Section 7 or Section 5." (Order of April 7, 1982, p. 9) The ALJ's scholarly analysis of the case law on this issue is exhaustive and his conclusions are accurate: if a merger may substantially lessen competition in the market in which it occurs, it is a violation of Section 7 of the Clayton Act, regardless of perceived social or political benefits it may create; the same rule should apply to the analysis of mergers under Section 5 of the Federal Trade Commission Act.

In determining whether a legal violation has occurred, antitrust analysis does not ordinarily permit consideration of factors other than those pertaining to competition in the relevant markets. *U.S. v. Philadelphia Nat'l Bank,* 374 U.S. 321, 371 (1963); *Nat'l Soc'y of Professional Engineers v. United States,* 435 U.S. 679, 692 (1978). While other factors might well be considered by the Commission in deciding whether to challenge a merger, or how to formulate an appropriate remedy, Congress set injury to competition as the ultimate legal standard for review under Section 7.* The number of conceivably relevant benefits to a merger that the Commission might consider, such as those suggested by respondent, is virtually limitless; and the weight that might be given to them is not readily apparent or even empirically ascertainable. The balancing of such

* Under certain circumstances, the analysis in preliminary injunction proceedings may be broader. *E.g., FTC v. Weyerhaeuser Co.,* 665 F.2d 1072 (D.C. Cir. 1981).

factors would, as complaint counsel argue, involve value judgments of the decisionmakers that would necessarily vary from case to case, and the meaning of the law would become unacceptably vague.

These same considerations militate against an interpretation of Section 5 that would similarly open up the area of inquiry in cases under the Federal Trade Commission act. The Commisssion sees no extraordinary circumstances that compel the interpretation of Section 5 as advocated by respondents.

The statements of various federal officials referred to by respondents indicate the existence of a public debate on how federal prosecutors may consider international trade in selecting cases for enforcement, and how the antitrust laws might be amended to take into account the effects of mergers on international trade. However, they do not evidence any dispute with regard to the meaning of current law.

For the aforesaid reasons, the appeal is hereby denied.

In The Matter Of

GENERAL MOTORS CORPORATION

DISMISSAL ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9077. Complaint, March 22, 1976—Final Order, June 25, 1982

On June 25, 1982, the Commission dismissed its complaint charging a major car manufacturer with violating Section 5 of the Federal Trade Commission Act by its use of a selective distribution system for new crash parts for GM automobiles and light trucks.

Appearances

For the Commission: *Donald K. Tenney, Alan H. Melnicoe* and *Myron L. Dale.*

For the respondent: *Edwin S. Rockefeller, Alan M. Frey, Richard Haddad* and *Charles L. Duffney, Bierbower & Rockefeller,* Washington, D.C., and *Francis H. Dunne,* in-house counsel, Detroit, Mich., for respondent General Motors Corporation. *Jerry S. Cohen, Kohn, Milstein & Cohen,* Washington, D.C., for intervenor National Automobile Dealers Association. *Jonathan T. Howe, Jenner & Block,* Chicago, Ill. and *Donald A. Randall,* in-house counsel, Washington, D.C., for intervenor Automotive Service Councils, Inc.

Complaint

The Federal Trade Commission, having reason to believe that General Motors Corporation, a Delaware corporation, has engaged in unfair methods of competition and unfair acts or practices in connection with the distribution of new service crash parts applicable to automobiles and light trucks assembled by General Motors Corporation, in violation of Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45) and that a proceeding in respect thereof would be in the public interest, issues its complaint, charging as follows:

1. For the purpose of this complaint, the following definitions shall apply:

(a) *Automobiles* are self-propelled, four-wheeled vehicles primarily for the transport of persons—they travel primarily on roads or streets and their seating capacity is for no more than 10 persons.

(b) *Light trucks* are self-propelled vehicles, other than automo-

biles, designed to carry a load or freight, having a gross vehicular weight of less than 10,000 pounds, and traveling primarily on roads or streets.

(c) *Service Parts* or *Replacement Parts* are new parts used to replace parts assembled as original equipment (*OE Parts*) in new automobiles and light trucks or used to replace service parts previously installed thereon.

(d) *Crash Parts* refers to any one or all of the following products: fenders, grilles, bumpers, hoods, deck lids, doors, quarter panels, rear end panels, rocker panels, lamp assemblies, wheel opening panels, fender and rear end caps, tail gates, radiator supports and shrouds, and mouldings, [2]including inner and outer panels and all components of these products as well as all parts necessary to attach the aforesaid to the bodies of automobiles and light trucks.

(e) *Service GM Crash Parts* are service crash parts applicable to automobiles and light trucks assembled by General Motors Corporation, sometimes hereinafter referred to as the *relevant parts.*

(f) *Distribution* refers to the business of *distributors.* Distributors are firms which either manufacture service crash parts or contract for their manufacture for the purpose of reselling them, principally to franchisees who wholesale or install the parts.

(g) *Wholesalers* are firms which resell service crash parts to installers but which may also install such parts. They neither manufacture service crash parts nor do they contract for their manufacture.

2. Respondent General Motors Corporation (hereinafter "GM") is and at all times relevant herein has been a Delaware corporation; its headquarters are at 3044 W. Grand Boulevard, Detroit, Michigan.

3. GM is now and for many years has been engaged in the manufacture, sale and distribution of a wide variety of products, including automobiles, trucks, buses, diesel locomotives, diesel engines, earth moving equipment, household appliances and automotive parts.

4. In 1972, GM had sales of $30.4 billion, net earnings after taxes of $2.16 billion, and total assets as of December 31, 1972 of $18.3 billion, ranking first in sales and profits and second in assets among the nation's largest industrial corporations. In 1975, GM had sales of $35.7 billion and net earnings after taxes of $1.3 billion.

5. GM is the largest manufacturer of automobiles and light trucks in the United States. Its principal domestic lines include Chevrolet, Pontiac, Oldsmobile, Buick and Cadillac automobiles and light trucks. In 1972, its total domestic sales of automobiles alone

amounted to 4,823,827 units, 43% of the U.S. market and 52% of U.S. sales by domestic manufacturers. [3]

6. GM sells and for some time past has sold substantial amounts of crash parts. In 1972, GM's sales of service GM crash parts exceeded $250 million.

7. In the course and conduct of its business, respondent GM is and for some time past has been engaged in selling service GM crash parts throughout various States of the United States, and has caused such parts to be shipped to purchasers in various other states. In so doing, GM is and at all times relevant herein has been engaged in a continuous and substantial course of trade in commerce and has affected commerce as "commerce" is defined in the amended Federal Trade Commission Act.

8. The number of automobile and light truck accidents occurring in the United States increases nearly every year. There were approximately 17 million accidents involving motor vehicles in 1972 alone. A substantial number of the motor vechicles involved in accidents are automobiles and light trucks manufactured by respondent. In 1972, there were 86.4 million automobiles registered in the United States; 41.1 million or approximately 47.6% of these automobiles had been manufactured by GM.

9. Crash parts comprise virtually the entire outer protective cover of an automobile or light truck and include the most frequently crash-damaged parts. While any automobile or light truck part is susceptible to crash damage on occasion, crash parts collectively account for the preponderance of all automobile and light truck parts replaced on account of crash damage. Unlike most other automobile and light truck parts, crash parts are almost always replaced due to crash damage rather than due to maintenance or mechanical failure.

10. All service GM crash parts are and for many years have been produced either by GM or by independent manufacturers for GM. All of the relevant parts are and for many years have been funnelled through GM for distribution. GM has and for some time has had and has intentionally maintained a monopoly and monopoly power over the distribution of these parts.

11. Unlike many other parts it sells, GM for many years has sold and continues to sell service GM crash parts exclusively to its franchise dealers who are located throughout the United States. GM's franchise dealers, individually and in concert, have concurred in, and urged upon GM, this policy of [4]selling to them exclusively; and GM has acquiesced in and adopted this policy so as to extend to its franchise dealers, when wholesaling and installing the relevant

parts, benefits of GM's monopoly position in the distribution of the relevant parts. The dealers depend on and have for some time depended on GM as their sole source for new GM automobiles and light trucks and certain replacement parts applicable to GM-made vehicles. GM owns or has a substantial financial investment in a number of these dealers. GM franchise dealers either install the relevant parts, wholesale them, or occasionally sell them to consumers. There are approximately 12,000 GM dealers in the United States, many of whom both wholesale and install the relevant parts.

12. GM franchise dealers wholesale and for many years have wholesaled service GM crash parts principally to independent body shops (IBSs). There are approximately 30,000 IBSs in the United States. IBSs compete and have competed with GM dealers in installing the relevant parts. Most of the relevant parts needed by consumers are and for many years have been installed by GM dealers or by IBSs.

13. Because GM has distributed and sold the relevant parts exclusively to its dealers, IBSs have had to purchase said parts from the dealers and in so doing have frequently paid more for the parts than have competing GM dealers.

14. GM has refused to sell the relevant parts to its franchise dealers on equal terms. The dealers receive wholesale incentives on only those relevant parts which fit the lines of new cars the dealers are franchised to sell. This has effectively precluded many GM dealers from wholesaling additional relevant parts.

15. Service GM crash parts are not installed in any vehicles other than those which have been assembled by GM. Furthermore, due to design proliferation by GM, any particular service GM crash part fits only one or at best a few models of GM vehicles. Thus, in excess of 5,000 different crash parts were designed to fit GM automobiles and light trucks produced for sale in the U.S. during model years 1968-1972.

16. Respondent, who has a monopoly in the distribution of service GM crash parts, has engaged for some time, and is continuing to engage, in the following unfair methods of competition and unfair acts or practices, among other: **[5]**

(a) refusing to sell the relevant parts—goods which the IBSs are under a commerical compulsion to obtain—directly to IBSs or to any potential suppliers to IBSs other than GM franchise dealers;

(b) bolstering its monopoly power through, among other things, selling the relevant parts exclusively to its franchise dealers;

(c) adopting a method of distribution which substantially hinders

competition in the distribution, wholesaling, and installing of the relevant parts;

(d) combining, agreeing or acting in concert with GM franchise dealers so as to substantially hinder competition in the distribution, wholesaling, and installation of the relevant parts;

(e) discouraging competition in the wholesaling of the relevant parts through utilization of disparate wholesaling incentives;

(f) maintaining a method of distribution which provides GM with an unfair competitive advantage in the sale to its dealers of parts available from alternate sources; and

(g) disseminating to GM franchise dealers lists which suggest the prices at which the relevant parts should be sold to installers and to members of the consuming public.

17. The effects of the acts, practices, methods, and power set forth in the preceding paragraph have been and are, among others, to

(a) deter new entrants and raise barriers to entry into wholesaling and installing the relevant parts;

(b) enhance monopoly power and maintain monopoly pricing and inefficiency in the distribution of the relevant parts;

(c) extend monopoly power and its effects in the distribution of the relevant parts to the wholesaling and installation of the relevant parts; **[6]**

(d) curb efficiencies in the wholesaling of the relevant parts;

(e) lessen competition in wholesaling the relevant parts;

(f) restrain competition between GM dealers and IBSs in installing the relevant parts;

(g) restrain competition among GM dealers in wholesaling the relevant parts;

(h) increase prices to and otherwise disadvantage IBSs in competing with dealer-owned body shops;

(i) decrease the availability of the relevant parts;

(j) decrease competition in the sale to GM dealers of alternate-sourced parts; and

(k) increase prices to and otherwise disadvantage the consuming public.

18. The acts, practices and methods of competition alleged in this complaint, coupled with the monopoly power alleged herein, constitute unfair methods of competition and unfair acts or practices by respondents in violation of Section 5 of the amended Federal Trade Commission Act.

Initial Decision

By Joseph P. Dufresne, Administrative Law Judge

September 24, 1979

The Complaint

1. The Complaint is dated March 22, 1976, and charges that General Motors Corporation (GM) engaged in unfair methods of competition and unfair acts or practices in violation of Section 5 of the Federal Trade Commission Act (FTCA), as amended (15 U.S.C. 45), in connection with the distribution of "new service [2]crash parts" applicable to automobiles and light trucks assembled by GM (Complaint, Introductory Paragraph).

Crash parts are defined therein as:

> . . . any one or all of the following products: fenders, grilles, bumpers, hoods, deck lids, doors, quarter panels, rear end panels, rocker panels, lamp assemblies, wheel opening panels, fender and rear end caps, tail gates, radiator supports and shrouds, and mouldings, including inner and outer panels and all components of these products as well as all parts necessary to attach the aforesaid to the bodies of automobilies and light trucks. (Complaint, ¶ 1(d)).

The definitions of *automobiles* and *light trucks* are those generally understood, but are limited, respectively, to autos having seating capacity for no more than 10 persons and trucks having a gross vehicular weight of less than 10,000 pounds (Complaint, ¶¶ 1(a) and (b)).

2. Paragraphs 11 and 12 of the complaint reflect: that GM sells crash parts exclusively to its approximately 12,000 GM franchise dealers located throughout the United States and that the dealers either (1) install the parts themselves, (2) wholesale them, principally to the approximately 30,000 independent body shop operators (IBSs) in the U.S. who compete with the dealers in installing the parts, or (3) occasionally retail the parts to consumers.

3. One allegation is that IBSs must purchase the parts from their competitors, GM dealers, frequently at prices higher than those paid by the dealers (Complaint, ¶ 13). Another is that since GM pays dealers wholesale compensation (explained below) only for crash parts for the brand of GM car the dealer sells (*e.g.,* no wholesale compensation is paid to a Pontiac dealer who sells crash parts for a Buick), many GM dealers are effectively precluded from wholesaling crash parts for brands of GM autos and light trucks for which the dealer is not franchised (Complaint, ¶ 14).

4. "Wholesale compensation" is a percentage of the list price GM

pays to (or credits to) the dealer on his sales of crash parts to a businessman/repairer of damaged vehicles (*i.e.,* an IBS or another dealer or commercial type purchaser but not to individual members of the public). In other words, wholesale compensation in the context of this case is a payment/rebate by GM to a dealer for performing a wholesaling function to the [3]automotive repair trade (Tr. 2005; CX 7010B).[1]

5. Wholesale compensation is available to a GM dealer only when he sells parts applicable to the vehicles for which he is franchised (RA 795–799) to purchasers such as an IBS or, with certain limitations, another GM dealer. Wholesale compensation is not paid on sales to an indepedent wholesaler (CX 7813A–B; Tr. 10266) (CCPF 47).

6. The wholesale compensation allowance was and is designed to afford car dealers a satisfactory margin of profit [4]on sales to IBSs and to encourage them to make crash parts available to the IBSs at the dealer price. On those parts for which a wholesale compensation allowance is provided, the *suggested* general trade price is identical to the price the franchised dealer is to pay to GM. *If* a dealer adheres to the intent of the program, an IBS pays the dealer the same price as the dealer is charged by GM for crash parts used in the dealer's body repair shop. (CX 7010B).

7. Starting with an allegation that GM has a monopoly in the distribution of GM crash parts, Paragraph 16 charges that GM

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1 The following abbreviations will be used in this decision:

Tr.	– Transcript followed by the page number.
CX	– Commission's Exhibit, followed by its number.
RX	– Respondents' Exhibit, followed by its number.
RA and CCA	– Respondents' and Commission counsels' Admissions.
ALJX	– Administrative Law Judge's Exhibit, followed by its number (Note: This device was used to insure that *all* pages of a document offered by Commission counsel, or that an exhibit the ALJ believed should be identified or included, became a part of the evidentiary record. For example, CX 7000A-G is typical. That exhibit consists of seven pages of a twenty-five (25) page letter dated May 12, 1967, from GM to Commission staff. Commission counsel declined to offer the complete letter. In that instance, ALJX-7 was used to identify and place the remaining eighteen (18) pages into evidence.)
CCPF, CCB and CCRB	– Commission counsel's Proposed Findings, Brief and Reply Brief.
RPF, RB and RRB	– Respondents' Proposed Findings, Brief and Reply Brief.
IX	– Intervenor NADA's Exhibit, followed by its number.
INPF, INB and INRB	– Intervenor NADA's Proposed Findings, Brief and Reply Brief.
IAPF, IAB and IARB	– Intervenor ASC's Proposed Findings, Briefs and Reply Brief.

engaged/engages in the following unfair methods of competition and unfair acts or practices, among others, by:

(a) refusing to sell the relevant parts—goods which the IBSs are under a commercial compulsion to obtain—directly to IBSs or to any potential suppliers to IBSs other than GM franchise dealers;

(b) bolstering its monopoly power through, among other things, selling the relevant parts exclusively to its franchise dealers (abandoned or dismissed later-see below);

(c) adopting a method of distribution which substantially hinders competition in the distribution, wholesaling, and installing of the relevant parts;

(d) combining, agreeing or acting in concert with GM franchise dealers so as to substantially hinder competition in the distribution, wholesaling, and installation of the relevant parts;

(e) discouraging competition in the wholesaling of the relevant parts through utilization of disparate wholesaling incentives;

(f) maintaining a method of distribution which provides GM with an unfair competitive advantage in the sale to its dealers of parts available from alternate sources (abandoned or dismissed later-see below) and;

(g) disseminating to GM franchise dealers lists which suggest the prices at which the relevant parts should be sold to installers and to members of the consuming public (abandoned or dismissed later-see below).

8. In Paragraph 17 it is alleged that:

The effects of the acts, practices, methods, and power set forth in the preceding paragraph have been and are, among others, to [5]

(a) deter new entrants and raise barriers to entry into wholesaling and installing the relevant parts;

(b) enhance monopoly power and maintain monopoly pricing and inefficiency in the distribution of the relevant parts;

(c) extend monopoly power and its effects in the distribution of the relevant parts to the wholesaling and installation of the relevant parts;

(d) curb efficiencies in the wholesaling of the relevant parts;

(e) lessen competition in wholesaling the relevant parts;

(f) restrain competition between GM dealers and IBSs in installing the relevant parts;

(g) restrain competition among GM dealers in wholesaling the relevant parts;

(h) increase prices to, and otherwise disadvantage IBSs, in competing with dealer-owned body shops;

(i) decrease the availability of the relevant parts;

(j) decrease competition in the sale to GM dealers of alternate-sourced parts (abandoned or dismissed later-see below) and

(k) increase prices to and otherwise disadvantage the consuming public.

9. The following order to Cease and Desist was proposed:

Requiring GM to sell crash parts, through and from whatever facilities it maintains to service its franchise dealers, to all vehicle dealers, independent body shops and independent wholesalers at the same prices, terms and conditions of sale, said prices to be subject to reasonable cost justified quantity discounts and stocking allowances. (Complaint, Notice of Contemplated Relief).

10. However, in his Reply brief, Commission counsel proposed a different order. That version includes definitions of *automobiles, light trucks, crash parts, components* of [6]crash parts, *service crash parts, service GM crash parts, independent wholesalers, independent body shops, functional discounts, quantity discounts* and non-exclusionary terms or conditions of sale. Thereafter, Part I of the order calls for an end to GM's use of functional discounts, as defined. Part II calls for GM to sell its crash parts to all vehicle dealers, independent body shops and independent wholesalers, as defined, at identical prices and on non-discriminatory, non-exclusionary terms except that ". . . graduated, non-cumulative, cost-justified volume and/or quantity discounts based solely on the sale of service GM crash parts" may be offered. Part III calls for submittal of a detailed plan to carry out the order no later than 90 days after the order is served on GM. Part IV calls for: (1) the plan to be put into effect 90 days after the Commission approves it; (2) notice to all GM customers for crash parts 30 days before a change takes effect and; (3) a notice in Automotive News or similar publication of each such change. Part V calls for an annual report to the Commission for five years on the anniversary of the date this Order becomes final "describing the manner of GM's compliance with parts I and II." (CCRB 132–136).

11. Commission counsel also moved in his Reply Brief (p. 98) for the acceptance of CX 7013A–H, which is a letter dated March 5, 1976 from GM to the Director of the Commission's Bureau of Competition. However, the record for the reception of evidence is closed and I am not convinced that it need be reopened to receive the letter because the subjects in the letter either are addressed elsewhere or would not add critical or important evidence. (Note: Commission Rule 3.51(d) permits reopening the record by the ALJ to receive additional evidence but it is not appropriate in this instance.)

GM'S ANSWER

12. GM answered the complaint on June 21, 1976, denying that the Commission had reason to believe that GM had engaged in unfair methods of competition and unfair acts or practices in distributing "new service crash parts", in violation of Section 5 of the Federal Trade Commission Act (FTCA), and denying that the proceeding would be in the public interest. To the numbered paragraphs of the complaint, GM:

(1) denied the accuracy and applicability to the proceeding of all definitions in the complaint except the one for automobiles (Answer, ¶ 1);

(2) admitted manufacturing and selling a wide variety of products, including automobiles and trucks, (Answer, ¶ 3);

(3) admitted sales in calendar year 1972 of $30.4 billion with after-tax profits of $2.16 billion, [7]and total assets of $18.3 billion, compared with 1975 sales of $35.7 billion with after tax profits of $1.3 billion (Answer, ¶ 4);

(4) admitted being the largest manufacturer of automobiles and light trucks in the U.S., (Answer, ¶ 1, 4 and 5);

(5) admitted that in 1972 GM sales of automobile replacement parts including "crash" parts exceeded $250 million (Answer, ¶ 6);

(6) admitted that GM engages in commerce and affects commerce (Answer ¶ 7);

(7) admitted that of the 86.4 million automobiles in U.S. operation in 1972, approximately 41.1 million had been manufactured by GM or its subsidiaries (Answer, ¶ 8);

(8) admitted "[a]ll service GM crash parts are, and for many years have been produced either by GM or by independent manufacturers for GM, . . . and have been funnelled through GM for distribution," but denied that it had or has ". . . intentionally maintained a monopoly and monopoly power over the distribution of these parts." (Answer, ¶ 10);

(9) admitted that it sells new GM crash parts exclusively to the approximately 12,000 GM dealers, some of which it owns or in which it has a financial investment, who either install or sell the parts, or do both (Answer, ¶ 11);

(10) admitted that any particular new GM crash part may not fit all models of GM vehicles and that in excess of 5,000 different service GM parts fit GM autos and trucks for model years 1968–1972 (Answer, ¶ 15).

GM either denied the remaining allegations or stated that it was without knowledge or information sufficient to form a belief regarding their truth.

13. As noted above, on pages 4–5, Commission counsel later abandoned or agreed to the dismissal of paragraphs 16(b), (f) and (g) and 17(j). (See "Order (1) Dismissing Paragraphs 16(b) and 17(j) Of The Complaint, and (2) Denying GM Motion For Interim Rulings To Guide Further Hearings" dated September 29, 1978; Tr. 10581). [8]

THE INTERVENORS

14. The National Automobile Dealers Association (NADA), which had on July 7, 1976, 8,690 members who were GM dealers, was permitted to intervene by order dated January 11, 1977. Counsel to

NADA has participated in the trial by questioning witnesses, calling his own witnesses, offering exhibits, making oral arguments, and submitting proposed findings and briefs.

15. In addition, the Automobile Service Councils, Inc. (ASC) which had over 2,000 independent body shop operators as members on October 3, 1978, was permitted to intervene by order dated October 16, 1978. Counsel to ASC has participated by filing briefs.

THE HEARINGS

16. Prehearing conferences were held in Washington, D.C. on April 7, July 29, September 22, October 29, and November 23, 1977, and on January 24, 1978 (CCPF, p. 1).

17. Both parties and intervenor NADA exchanged trial briefs in support of their respective positions. These included legal arguments and lists with copies of proposed exhibits and the names of witnesses with short narrative summaries of expected testimony.

18. The hearings began in Washington, D.C., on May 15, 1978. The record for the reception of evidence was closed on May 22, 1979. In all, there were 82 days on which hearings were held, including an inspection of the GM parts warehouse in Baltimore, Md. There are approximately 16,285 pages of transcript. (Note: There are some gaps in pagination due to changes from "routine" to "daily" or from "daily" to "rush" copy, *e.g.*, Feb. 2–5, 1979, April 18, 1979. When such changes occur the reporter must estimate the number of pages required for transcription of notes. If the estimate is low a gap in pagination results.)

19. Sixty witnesses testified for the Commission, 21 testified for GM, and 3 testified for NADA (RB 1). Of these, 24 were IBS witnesses from the following seven trade areas: Buffalo, New York; Mansfield, Ohio; Cleveland, Ohio; New Orleans, Louisiana; St. Louis, Missiouri; Spokane, Washington; and Tucson, Arizona (ALJX 26). In addition, testimony of two IBS witnesses was stipulated (CCPF 106; RRB 106).

THE STRIKING OF TESTIMONY AND REJECTION OF EXHIBITS

20. The testimony of four GM witnesses was stricken because counsel for GM declined to observe my order that they were to hand over to Commission counsel pretrial reports of interviews [9]of witnesses. My "Order Granting Motion of General Motors Corporation for Production of Interview Reports" dated April 10, 1978, called for each side to provide the other with ". . . all interview reports relied upon in connection with the witness's testimony" one week before a witness testified. The purposes of the order were to have

each side apprise the other, within reason, of testimony to be elicited by Commission counsel in connection with the allegations in the complaint, the defenses of GM, to encourage counsel to execute stipulations, and otherwise to expedite the trial (Tr. 10619–20). The order was discussed at considerable length at the hearing on Septemter 27, 1978 (Tr. 10581–10629; 10672–10693). Commission counsel made it clear that he had maximally complied with the order (Tr. 10624–25).

21. On that date, in the course of the hearing (Tr. 10582) and later in connection with the testimony of GM witnesses Cann on October 2 (Tr. 11119–11179), Mack on October 5 (Tr. 11555–11701), Faulkner on October 6 (Tr. 11718–11817), and Vulbrock on October 17 (Tr. 12280—12354), Commission counsel raised the question as to whether any interview reports existed.

22. Counsel for GM said that he had no document/interview reports within the purview of the order and that, even if he did, an ALJ lacked authority to compel what the April 10 order required. Thereafter, Counsel for GM showed me some papers/notes. After examining them I concluded they were interview reports within the scope of the order. However, Counsel for GM continued to decline to hand over copies to Commission counsel. After I made some handwritten marks on them to identify those portions deemed privileged, the reports were returned to counsel for GM. The "Order Denying Motion for Reconsideration of Order of September 27, 1978, Requiring the Production of Interview Reports" dated October 13, 1978, elaborates on the action taken at the hearing.

23. The "Order Modifying Order Granting Motion of General Motors Corporation for Production of Interview Reports" dated October 31, 1978, ordered the striking of the testimony of the four GM witnesses. (See Commission Rule 3.38). Thereafter, the four documents were placed in a sealed envelope and delivered to the Commission's Secretary so that they may be examined by the Commission upon its review. (See "Order Re In Camera Documents Delivered to the Commission's Secretary" dated Feb. 14, 1979).

24. The testimony (Tr. 8750–8787) of a Commission witness whose name and testimony are *in camera,* at his and Commission counsel's request was stricken as being cumulative (Tr. 8787) (CCRB ¶ 2). Parts of the testimony of Commission witness Perschall were stricken for a time because the parts were unreliable, due to their being based on documents prepared by another person, with these foundation documents either not produced at the hearing or not being credible. However, the [10]testimony was reinstated without objection by counsel for GM after underlying documents were

provided. (See "Order Reinstating Stricken Testimony of Commission Witness Kenneth Perschall" dated May 25, 1979).

25. In accord with Commission Rule 3.43(g), the rejected exhibits and testimony remain a part of the official record, although they have not been considered in reaching or preparing this Initial Decision.

BASES FOR THE FINDINGS OF FACT

26. The following findings of fact are based on a review of the allegations made in the complaint, respondent's answers, the documentary evidence, and consideration of the demeanor of the witnesses.

27. The proposed findings of fact, conclusions, and proposed orders, together with reasons and briefs in support thereof filed by each side and by the intervenors have been given careful consideration. Many proposed findings have been adopted as submitted or in substance. To the extent not adopted by this decision in the form proposed or in substance, they are rejected. Further, any motions not ruled upon are denied.

28. For convenience, the findings of fact include references to supporting evidentiary items in the record. Such references are intended to serve as guides to the testimony, evidence, and exhibits supporting the findings of fact. They do not necessarily represent complete summaries of the evidence considered in arriving at such findings.

FINDINGS OF FACT

Background

29. The Commission investigation of the distribution and sale of crash parts which, essentially, are fenders, grilles, moldings, etc. began in the mid-1960's. Operators of IBSs had complained to the Commission that automobile dealers were charging them excessive prices for crash parts, thereby making it difficult to compete with dealers for collision repair business. The IBSs sought to buy crash parts at the same price that automobile dealers paid for parts used in their own repair shops (ALJX 14M, Supp. to CX 7014).

30. Prior to September 12, 1967, GM simply provided its dealers with a suggested general trade price to be charged wholesale purchasers of crash parts (CX 7015A). GM estimates that under that system wholesaling dealers allowed purchasers at wholesale an average discount in excess of 18% from the list price (CX 7015B).

31. On September 12, 1967, GM proposed a plan to its [11]dealers

calling for the payment of an overriding discount of 12% from dealer price to any GM new car dealer on a "qualified wholesale sale" of seventeen (17) categories of crash parts, including: fenders; grilles; bumpers; radiator supports; and body side moldings. A "qualified wholesale sale" would be the sale and delivery (less returns and repurchases by the dealer) of such parts to:

Automotive repair shops, automotive body shops and gasoline service stations which purchase the eligible General Motors parts for the repair, rebuilding or servicing of General Motors vehicles for such purchaser's retail and service customers, except any such purchaser in which the selling dealer, or any stockholder or principal thereof, owns or controls any financial interest (CX 7015C).

32. In February, 1968, the Commission advised GM that it intended to bring suit to bring about price parity between franchised car dealers and independent body shops (ALJX 14N, Supp. to CX 7014z)

33. After negotiating with Commission staff and prior to adopting the wholesale compensation plan, GM stated:

General Motors' cost would be increased by the amount of the discount, by the cost of administering the program to insure against fraudulent claims (by GM dealers), and by the costs of the routine paperwork to administer the program. All of those additional costs would have to be factored into prices for these parts, *resulting in significant price increases to the consumer* (Emphasis added) (CX 7000E; CCPF 299).

In other words, it was the judgment of GM's top management that if wholesale compensation were necessary to save the basic structure of GM's distribution system, the overall advantages outweighed the costs of wholesale compensation (ALJX 7 and 8) (RRB 299).

34. After many discussions with Commission staff, GM and the three other principal U.S. auto makers agreed in the fall of 1968 to implement a wholesale compensation plan (CX 7010D). As early as November 21, 1966, Commission staff had told GM representatives that the basic reason for the investigation was ". . . to require General Motors to distribute its captive sheet metal parts [i.e., crash parts] on the same terms as it presently distributes its competitive parts," *e.g.*, sparkplugs, filters, etc. (RX 26A).

35. The Commission announced on October 22, 1968, that "the leading automobile manufacturers" had agreed to adopt such a [12] wholesale compensation plan for crash parts ". . . to help overcome what the Commission considers to have been competitive disadvantages facing independent auto body repair shops." GM put the plan into effect with the introduction of the 1969 models (ALJX 14N, Supp. to CX 7014).

36. The Plan did not provide for an allowance when a dealer

wholesaled a crash part intended for a light-duty truck or for several passenger car lines, including the Chevrolet Corvette, Vega and Monza, Pontiac Astre, Oldsmobile Starfire, and Buick Opel and Skyhawk. This was because no imported car manufacturer or distributor was known to make a wholesale compensation allowance available to its dealers and those lines/makes were considered to compete for the most part with imports (CX 7010C). Approximately 15 different foreign car manufacturers sell new cars in the United States (CCA 43).

37. GM pointed out that if GM made such an allowance available and the manufacturers of foreign makes did not, one of two things could happen: (1) It could make no change in the dealer net price, in which case GM would have to absorb the cost of a 25 percent allowance on the wholesale portion of its crash parts business in the excepted car lines, *i.e.,* Corvette, Vega, Monza etc. which on the basis of 1974 sales at 1974 prices, would cost at least $17 million per year; or (2) GM could increase the price for crash parts, in which case they would cost more than a similar part for a competing import (CS 7010D).

38. Under the plan adopted, average wholesale compensation was 23% plus a possible additional 5% Stock Order (PAD) Allowance (described at p. 37) applied to purchases (CS 7018). On October 1, 1968, GM's prices on the specified parts were increased to enable GM to recover the amount that would be lost from making the increased wholesale compensation payments (CX 7022A).

39. In a January 31, 1969, GM review (CX 7021A and B) the following were noted:

(1) The Service Section, in collaboration with representatives from each of the five car divisions, established overriding discounts on the categories of parts selected by the Federal Trade Commission;

(2) The discounts ranged from a minimum of 20% on high value top and quarter panels to a maximum of 25% on nine categories of parts priced under $20.00 at the dealer level. Overriding discounts of 22% and 23% were applied to the remaining categories such as fenders, hoods, and deck lids. The average overriding discount for all of the parts was estimated to be 23%; however due to some [13] changes in price levels, the actual rate for the five car divisions was 22.4%;

(3) The financial effect on General Motors of adding wholesale compensation on 10,208 parts in the FTC selected categories was estimated to be slightly over $18,000,000, computed on 1966 volume.

This amount was recovered by increasing dealer prices 1.4%, applicable to all parts including crash type items;

(4) Dealers' gross profit dollars had been reduced 18.4% but the percent of profit increased from 26.9% to 27.4% (CX 7021A);

(5) The amount of decrease in gross profit dollars and percent of profit varied among divisions as illustrated in the following table:

	Gross Profit Amount				Gross Profit Percent		
	Millions		Change				Change
	Old	New	New vs. Old		Old	New	New vs. Old
$	$	%	%	%	%	%	%
Chevrolet	134.81	114.92	(19.89)	(14.8)	25.9	27.3	1.4
Pontiac	157.13	118.45	(38.68)	(24.6)	28.5	27.4	(1.1)
Oldsmobile	147.85	112.27	(35.58)	(24.1)	28.5	27.6	(.9)
Buick	190.32	146.67	(43.65)	(22.9)	27.9	27.3	(.6)
Cadillac	192.09	178.75	(13.34)	(7.0)	24.5	27.2	2.7
Total	822.20	671.06	(151.14)	(18.4)	26.9	7.4	.5

Both Chevrolet and Cadillac were affected to a lesser degree than the other three divisions because of a difference in the pricing and discount patterns of the old program, whereas under the new program, a uniform pattern applicable to all five car divisions was adopted.

(6) Dealers had been operating in the area of a 25% gross profit on wholesale sales for the previous three years and dealers would show an increase in profit dollars on their retail sales due to increases in parts prices;

(7) Since dealer expenses had been increasing and there was a need to encourage dealers to engage in the wholesaling of crash parts, an increase in the wholesale compensation allowance might be in order. The cost to General Motors was estimated [14]to be approximately $850,000 for each additional percent allowed (CX 7021B).

40. In the fall of 1969, GM's suggested list prices on both replacement and crash parts again were increased. The increases averaged approximately 4%, with no part raised in excess of 6 ½%. Changes also were made in base discounts to dealers from GM's list prices. It was forecast that the change in the base discount rate would result in a slight reduction in the dealers' average gross margin on retail sales, but that this would be more than offset by an increase in wholesale compensation. Dealers began to receive a base discount of 40% and a standard wholesale compensation rate of 25%. Previously the discounts had ranged from 35% to 44% and wholesale compensation rates had varied from 20% to 23%, depending upon

the parts groups involved. All part numbers within each compensable parts group were made eligible for wholesale compensation (CX 7023A–B).

41. Generally, each increase in the dealer price due to changes in the rate of wholesale compensation was accompanied by a proportionate increase in the list price of the relevant parts (RA 904, RA 905). This was due to GM's maintaining the dealer price at approximately 40% of the list price (CX 7225C) (CCPF 304).

42. Crash parts were made eligible for both the 5% Stock Order (PAD) Discount and wholesale parts compensation. The object was to assist dealers in greater penetration of the wholesale parts market, both replacement and crash, which was estimated to be approximately six times larger than the total retail parts market. As an example, a carburetor, Group 3.725, having a compensation rate of 12.6% (which indicated that only approximately 50% of the volume of parts in that group were formerly eligible for wholesale compensation) was made eligible for 25% wholesale compensation in that group (CX 7023A–B).

43. The "General Motors Parts Division Body Shop Price Schedule" (CX 7422A–Z–3) contains a suggested list price and a suggested trade price for the automotive replacement parts GM offers for sale to its dealers (Tr. 2056). The list includes all of the parts which are in the definition of crash parts contained in the complaint in this matter (Tr. 2056). The dealer net price, before other discounts or rebates, is the same as the suggested trade price and is the price GM recommends dealers charge to IBSs and other commercial auto body repairers (Tr. 2059).

44. In 1970, another FTC investigation of the effects of wholesale compensation began (RX 28F). The staff concluded: (1) that wholesale compensation had not achieved price parity between dealers and IBSs; (2) that prices to consumers had risen; and (3) that there would be an estimated 10% drop in consumer prices if wholesale compensation ended (RX 28G). **[15]**

45. On March 21, 1972, still another investigation was initiated to look into ". . . possible monopolization of crash parts by the auto makers" (RX 28H). There were many discussions within GM regarding ways to resolve the controversy with the FTC (Tr. 2224). Two objectives were to settle the controversy and to reduce or eliminate wholesale compensation costs (Tr. 2143, 2168) (CX 7253) (RPF 259).

46. On July 11, 1975, a settlement proposal was made to Commission staff under which GM would sell crash parts directly to any IBS at the dealer net price from the 27 field warehouses

operated throughout the United States if that proposal would end the investigation. GM acknowledged that the Robinson-Patman Act (15 U.S.C. 13) would require that the independent body shop operators be accorded the same prices and services as the dealers (CX 7010E).

47. The proposal called for car dealers to continue to distribute the overwhelming majority of crash parts to independent auto body repair shops and to receive wholesale compensation from GM for doing so. GM did not intend to substitute its 27 warehouse distribution locations for the dealers' 12,000. Rather, the warehouses would be an alternative source when an IBS operator felt that he could not buy the crash part he needed at a competitive price from a dealer (ALJX 13D, Supp. to CX 7012).

48. Also, in the summer of 1975, the Commission retained Cambridge Management Associates, management consultants, to survey existing warehouse distributors to determine whether they would be interested in selling crash parts. The survey contemplated that the distributors would sell to jobbers, who in turn would sell to the IBSs or to car dealers who chose to buy from them rather than directly from the manufacturer. It was projected that the jobber—an additional link in the distributive chain—would need an average gross margin of 25%–46% to perform *his* function (ALJX 14S, Supp. to CX 7014).

49. In October, 1975, the Automotive Warehouse Distributors Association (AWDA) whose membership accounts for the great bulk of independent wholesale parts distributors, advised the Commission that its members were not interested in distribution of sheet metal parts (*i.e.,* crash parts) and that they were not equipped to stock and handle them (ALJX 14T, Supp. to CX 7014). AWDA is a trade association representing approximately 500 of the nation's 1000–1500 warehouse distributors (WDs). GM is also a member of AWDA. WDs sell automotive replacement parts to jobbers who resell them to installers (IX 2; Tr. 2248; 8640–41) (CCPF 322).

50. AWDA opposed IW–IBS access in order to prevent its WD members from facing additional competition (Tr. 12588). The **[16]** members feared that GM would sell maintenance-type (replacement) parts, as well as crash parts, to independents and that this would place GM in direct competition with WDs for jobber business. If GM sold crash parts only to IBSs, AWDA would not oppose IW–IBS access (Tr. 12591–92; 12664–66). (CCPF 323). A former executive of AWDA testified that changing the distribution system might reduce the availability of crash parts (Tr. 12523–24) (RRB 323).

51. In early October, 1975, GM raised the amount of the

wholesale compensation allowance from 25% to 30% (ALJX 13G, Supp. to CX 7012).

52. Later, on February 5, 1976, in another proposal to the Commission, GM said that it would broaden the Wholesale Compensation Plan by paying a dealer an allowance for the sale of eligible crash parts to an IBS for any make of GM car, *e.g.,* a Pontiac dealer than would be able to obtain wholesale compensation on the sale of Chevrolet, Oldsmobile, Buick and Cadillac crash parts (ALJX 13G, Supp. to CX 7012). Under this proposal, any of the 12,000 GM dealers would have been able to claim wholesale compensation whenever an eligible crash part, regardless of the make of car it fit, was sold to an IBS (ALJX 13H, Supp. to CX 7012). This proposal was made after GM officials concluded that the July 11, proposal would not be acceptable (ALJX 13B, Supp. to CX 7012).

53. In addition, the proposal called for GM to make crash parts for subcompacts and light duty trucks eligible for wholesale compensation on a trial basis, with the option of changing at the end of six months if GM's principal competitors, including the foreign manufacturers, did not implement a similar plan (ALJX 13I, Supp. to CX 7012).

54. Also in 1976, on March 1, 8, and 12, the Subcommittee For Consumers of the Committee on Commerce of the United States Senate conducted hearings on the cost of automobile crash parts and subsequently published "Automobile Crash Parts", the transcript of the hearings for the use of the Committee on Commerce (ALJX 17). At the hearings the Director of the Commission's Bureau of Competition testified that GM's February 1976, proposal was "particularly disappointing" (RX 28J), "totally inadequate" and that the wholesale compensation plan had "raised prices to consumers without achieving its goal of price parity for IBSs" (RX 28K). He also commented that State Farm Mutual Automobile Insurance Company favored requiring the auto makers to sell directly to independent wholesalers (RX 28I–J).

55. Later that month the February proposal by GM was rejected by the Commission and the Complaint was issued. See p. 1. [17]

The Respondent

56. General Motors Corporation is a Delaware corporation organized on October 13, 1916, with its headquarters at 3044 W. Grand Boulevard, Detroit, Michigan. (Answer, ¶ 2). GM is the successor to the General Motors Company, which was organized on September 16, 1908 (RX 310R).

57. GM is, and for many years has been, engaged in the manufacturer and sale of a wide variety of products, including automobiles, trucks, buses, diesel locomotives, diesel engines, earth moving equipment, household appliances, and automotive parts (Answer, ¶ 3). The principal makes of automobiles GM manufacturers and sells in the United States are: Chevrolets, Pontiacs, Oldsmobiles, Buicks, and Cadillacs (RA 746 and 748). There is a separate GM division for each of these, with each division franchising dealers to sell its own make of auto (Tr. 1999). Trucks are franchised by the Chevrolet Division and the General Motors Truck and Coach Division (Tr. 1999). A dealer franchised to sell several makes is franchised by each division whose brand he sells (Tr. 2000–2001).

58. GM and its dealers' primary business and interest is in selling cars and trucks (Tr. 9869; 12651) (CCPF 183).

59. New car customers expect the manufacturer of the car that they buy to see to it that parts and service are available for that car (Tr. 11008). As a consequence, car manufacturers such as GM must provide the necessary back up stocks of parts (Tr. 11009; 13978–79). Many other considerations such as the car's styling, size, sticker price, gas mileage, and resale value are at least as important to a prospective car purchaser as the cost of crash parts (Tr. 1382) (CCPF 185).

60. Accident repair costs are of little, if any, importance to most purchasers buying an automobile since they believe their insurance will cover damage expenses above the deductible amount (CX 7815P) (CCPF 188).

61. GM automobiles come in 12 different body sizes. As many as four car divisions produce unique models of the same body size. Generally, each body size and each division's model of that body size consists of both unique and common crash parts, *e.g.,* Chevrolet's B-body Impala and Caprice (Tr. 10124–30, 10153–55) (CCPF 13) (RRB 13).

62. In 1976, GM-manufactured automobiles accounted for 45.5% of total U.S. automobile registrations and GM trucks for 42% of total U.S. truck registrations (CX 7409A, C).

63. GM also sells various maintenance type automotive replacement parts such as wire and cables, spark plugs, brake shoes, batteries, and carburetors to nondealer resellers who [18]sell to installers, including some GM dealers (RA 757, 758, 761).

64. The following table shows in greater detail and for more recent years the level of operations of GM (RX 310P and Q):

	1977	1972	1967
Net Sales	$54,961,272,516	$30,436,231,414	$20,026,252,468
Net Income	$ 3,337,527,231	$ 2,162,806,765	$ 1,627,276,076
Dividends on Stock:			
Preferred	$ 12,928,261	$ 12,928,270	$ 12,928,276
Common	$ 1,944,714,370	$ 1,273,066,301	$ 1,084,355,349
Net Income Retained for Use in Business:	$ 1,379,884,600	$ 876,812,194	$ 529,002,451
Expenditures for Plant and Equipment (Excluding Special Tools)	$ 1,870,930,827	$ 940,037,584	$ 912,629,617
Payrolls Worldwide	$15,270,777,726	$ 8,668,223,736	$ 5,634,191,663
Average No. of Employees Worldwide	796,848	759,543	728,198
Number of Stockholders	1,245,384	1,284,825	1,399,113
Cars Manufactured In the U.S.	5,258,583	4,778,124	4,581,315 (1968)
Trucks & Coaches Manufactured in the U.S.	1,436,220	962,316	829,005 (1968)
Cars and Trucks Manufactured outside the U.S.	2,373,010	2,050,085	1,676,694 (1968)

65. GM is the largest manufacturer of automobiles and light trucks in the United States (Answer, ¶ 5). The only light trucks which GM manufactures and sells in the United States are made under the Chevrolet and GMC names (RA 750).

66. In 1972, GM sales of automotive replacement parts, including *crash parts,* as defined in the complaint, exceeded 250 million dollars (Answer, ¶ 6).

67. GM engages in a continuous and substantial course of trade in commerce and affects commerce throughout the United States (Answer, ¶ 7).

Crash Parts

68. All service GM crash parts, as defined in the complaint, are, and for many years have been, produced either by GM or by independent manufacturers for GM. They are distributed by GM exclusively to its dealers who either wholesale, otherwise resell, or install the parts (Answer, ¶ 10). Michael C. Mehan, Executive in charge of GM's U.S. service parts operations, *i.e.,* General Motors Parts Division (GMPD) and AC-Delco Division, testified that the parts enumerated in the complaint are crash parts but did not agree that the definition was all inclusive (Tr. 2009).

69. GM sells most of its crash parts exclusively to approximately 12,000 GM dealers (Answer, ¶ 11). However, not all GM dealers have body shops (CCA 61).

70. As of December 31, 1974, GM owned and operated 23 GM dealerships and had a temporary financial interest in 379 (RA 764). Some of the 23 and many of the 379 conducted body shop operations (RA 767 and 769) and many of each category resold crash parts to installers in 1974 (RA 768A, 770A).

71. There are more than 5,000 different crash parts for GM 1968–72 model year automobiles and trucks (Answer, ¶ 15). There are 112 different Chevrolet fenders. In recent years Chevrolet has sold an average of 4,500 of each different fender in each year. Since there were approximately 6,500 Chevrolet dealers (as of May 12, 1967), Chevrolet dealers buy an average of less than one fender per year of each different fender (CX 7000D).

72. All crash parts produced by independent manufacturers for GM are produced from tooling GM owns except for parts for [19]step vans (RA 720).

73. On eligible parts dealers currently receive a rebate of 30% (wholesale compensation) of the dealer price on qualified sales to wholesale customers, including IBSs (Tr. 2068–70, 10252–54, 10294).

74. Crash parts as a class are bulky and require considerably more space for storage than replacement parts. They are more easily damaged and harder to handle than the typical replacement part (Tr. 12509–10; 12629–30; 10459–61; RX 51S) (RPF 79).

75. GM does not pay wholesale compensation on dealer resales of crash parts exclusively used on a brand of automobile the dealer is not franchised to sell, *e.g.,* a Chevrolet dealer selling a crash part for a Pontiac (RA 795–799).

76. GM pays wholesale compensation on resales of eligible crash parts by its dealers: (1) to independent automotive repair shops, body shops, gasoline stations, fleet users (5 car or light truck minimum); (2) to non-GM-dealer new car or truck dealers, *e.g.,* Ford, American Motors, British Leyland; (3) on *emergency* sales to another GM dealer to meet a service customer's needs or to an outlying GM dealer who has been approved as a buyer by the cognizant GM franchising division of GMPD; (4) to independent used car and truck dealers; (5) federal, state, county, and municipal government agencies. Sales: (1) to retail customers, (2) to insurance companies for use on a vehicle owned or titled in the name of an insured, (3) to a department of the selling dealer's dealership, or (4) to anyone who purchased eligible parts for resale directly or indirectly to a GM car or truck dealer, are typical of those resales for which wholesale compensation *is not* to be claimed (RA 801, Attachment A).

77. In order to get his rebate and after he has wholesaled the part, the dealer files a report in which compensation is claimed (Tr. 2006). Wholesale compensation *is not* to be paid to a dealer for a part used in the dealer's own body shop (Tr. 4753; Tr. 11020) and is to be paid on dealer-to-dealer sales only if an emergency existed or if the sale had prior GM approval (*e.g.,* to an isolated dealer in a remote location) (Tr. 2087–90; CX 7253D) (RPF 34).

78. Wholesale compensation payments require substantial administrative expenses in addition to the cost of the payments. For a GM dealer to obtain wholesale compensation, he must obtain a form from GM, keep track of qualified sales, enter the sales on the form, and send the form to GM. GM must transmit the form to the dealer, receive it back, process it, issue credits, and, on occasion, audit dealers (CX 700E; Tr. 2165–66, 11972–74) (CCPF 307). **[20]**

79. The added costs of wholesale compensation are not offset by any other benefits, such as the receipt of superior service. GM dealers do not perform any services under the wholesale compensation plan that they did not perform prior to its adoption (Tr. 10231). To receive wholesale compensation on crash parts, GM dealers need not stock, maintain any facilities, deliver, solicit sales, pass out

technical bulletins, or do anything else except sell to qualified purchasers (Tr. 2201, 10239–40) (CCPF 309).

80. Except for parts carried over for use as original equipment in successive model years, service GM crash parts typically are inventoried, for 7 to 12 years (RA 864).

81. GM does not rechrome or sell rechromed bumpers, or salvaged/used crash parts (RA 867–869).

82. In 1975, more than 13,000 crash parts were included in GM's wholesale compensation plan (RA 893).

83. When GM increases dealer prices, it usually also increases suggested list prices so that the discount from suggested list to dealer net price remains approximately the same as before the price change (RA 905).

84. GM usually starts production of a 6 to 8 months' supply of crash parts for automobiles and light trucks at least 2 months prior to introducing the new model (RA 913 and 916).

General Motors Dealerships

85. The basic policy of GM is and has been to distribute its cars through independently owned and operated dealerships (CX 7029B). There are about 5,000 GM dealers who wholesale GM crash parts (Tr. 10285). There are approximately 7,000 additional who could purchase and wholesale crash parts (RX 2). (RPF 183).

86. As of February 24, 1977, in the United States the various divisions making GM cars had the number of dealers shown: Cheverolet-5992; Pontiac-3239; Oldsmobile-3322; Buick-3025 and; Cadillac-1616 (RX 33B–F).

87. GM at one time owned automobile dealerships in the Manhattan section of New York City but these were phased out in 1976. GM currently owns and operates no automobile dealerships but does own 18 truck dealerships, which are primarily involved in the sale and service of medium and heavy duty trucks (Tr. 9863–64) (RPF 186).

88. To facilitate the opening of dealerships, GM has a Dealer Investment Plan operated by its Motors Holding Division [21](MHD) (CX 7029C). As of October 31, 1964, of 13,395 dealerships, 306 or 2.3% of the total, were operating under the MHD Plan (CX 7029C).

89. As of December 31, 1977, GM had a financial interest in 345 or 3% of the 11,660 GM dealerships in business (RX 34).

90. MHD dealerships accounted for an estimated 4.3% of total GM dealer wholesale parts sales and an estimated 5.3% of total GM dealer body shop sales (RX 34; RX 38; RX 40) (RPF 187(d)).

91. Under the plan the entrepreneur/dealer provides at least 25% of the capital required and MHD provides the balance. The dealer gets voting stock and is paid a salary. He buys MHD-owned stock in the dealership in order to increase his interest (CX 7029D–E). The dealer-operator conducts the day to day operations (Tr. 9846–47; CX 7029E). However, two MHD representatives sit on the board of directors (CX 7029E). Between 1929 when the plan began and 1964, 1,139 dealers bought their businesses in this way (CX 7029F).

92. The interest of MHD is limited in duration. Between 1970 and 1977, the average length of time during which MHD held financial interests in such dealership ranged from five years, three months, to six years, seven months (RX 34).

93. MHD financed dealers are free to buy parts from any source they choose and otherwise to operate their dealerships as they see fit. Purchases of parts from GMPD are on the same terms and conditions as those made by other dealers and any resales are made at dealer-chosen prices. Such dealers are audited periodically to determine the status of MHD's investment and to advise the dealers concerning efficiency of their sales and other methods of operation (CX 7029G).

94. Each car manufacturer has the same incentives GM has to distribute crash parts in the most efficient way possible (Tr. 15751–55; 15794–95) (RPF 102). All U.S. auto manufacturers and all foreign automobile companies that have been selling cars in the U.S. since the early 1960's now distribute crash parts basically in the same way (Tr. 2223; Tr. 9870) (RPF 103). But see "Chrysler's Mopar Experience", page 36.

95. The terms of the contract between GM and its various dealers are set forth in a "Dealer Sales And Service Agreement". The agreement usually is executed for GM by the general sales manager of the division responsible for the make of car the dealer sells, another GM official, and a partner or the proprietor of the dealership (RX 228–13). The contract calls for the dealer to ". . . carry in stock at all times an inventory of Parts and Accessories adequate to meet customer demands and for warranty repairs, special policy adjustments and campaign corrections . . ." Neither dollar amounts nor number of [22]items to be inventoried is specified in the contract (RX 2–W). The agreement also authorizes GM personnel to examine and audit the books of the dealership (RX 2–Z).

96. GM makes recommendations as to the space which *should* be devoted to the parts department which are based on the dealer's anticipated monthly sales of cars ("Planning Potential") and Net Dollar Inventory. The following table illustrates this:

Planning Potential	Sq. Ft.	Net Dollar Inventory	Sq. Ft.
50	1200	$ 10,000	1500
101-125	1700	40,000	4500
201-225	2200	80,000	8500
301-350	3300	150,000	14000

(CX 7234B)

97. GM also recommends a mix of parts inventory on a model year basis which its dealers *should* have. The optimum pattern per GM calls for the inventory to be broken down as follows:

Year	%
Current Model	10%
1 Year Old	20%
2 Years Old	25%
3 Years Old	20%
4 Years Old	15%
5 Years or Older	10%

(CX 7274E)

98. The dealer is required to use and keep up to date a satisfactory uniform accounting system of a type designated by GM and to furnish to GM ". . . by the tenth of each month, complete and accurate financial and operating statements . . ." (RX 24). GM audits some dealers claims under the wholesale compensation plan (RA 806) and reviews the records of all of its dealers (RA 811A).

99. In wholesaling eligible service GM crash parts a GM dealer can obtain 30% lower prices on parts that are uniquely applicable to the make of automobile he sells than can GM franchise dealers who are franchised to sell other makes (see RA 923A).

100. GM dealers and IBSs perform most of the body repair work which is done on GM automobiles and light trucks [23](Tr. 1202). GM dealers are the principal competitors of IBSs in performing such repairs (RA 774–5; Tr. 1201–02). IBSs do body work on all makes of vehicles but most GM dealers tend to specialize in repairing the models they sell (Tr. 1200–01, 9495, 9498) (CCPF 39).

101. The price GM dealers charge IBSs for new GM crash parts may vary throughout the United States (CCA 55).

GM Dealers as Parts Wholesalers

102. GM dealers are not expected to stock all or even some of the slowest moving crash parts (Tr. 10086–88). In states where there is an inventory tax, GM dealers do not want these slower-moving parts

to sit on their shelves. They prefer to carry faster-moving items (Tr. 6982–83) (RPF 77).

103. GM dealers need not engage in parts wholesaling or the operation of a body shop (Tr. 9094). If they wholesale parts, they are not required to stock parts (Tr. 9904–05; 10268). The dealer determines which parts if any he will stock for any of his operations. GMPD does not control the inventory practices of GM dealers (Tr. 9094; 9907) (CCPF 36).

104. Dealers usually do not wholesale crash parts for makes of cars they do not sell (Tr. 2126). If wholesale compensation were paid on such sales some dealers would enter that field and others would drop out (Tr. 2132).

105. Each of the crash parts listed in paragraph 1D of the complaint is eligible for wholesale compensation (Tr. 2019).

106. A GM dealer is at an automatic 30% price disadvantage in wholesaling non-franchise crash parts, *i.e.,* those for makes he is not franchised to sell (Tr. 10263–64, 10266). This constitutes a near total entry barrier to such sales (Tr. 14015), as relatively few GM dealers do in fact wholesale crash parts for makes for which they are not franchised (Tr. 2126) (CCPF 255).

107. It is the position of NADA that elimination of this limitation would benefit IBSs and increase availability of parts to consumers at lower cost by increasing the competition among franchised dealers selling different model vehicles (CX 7327G). In its February, 1976, settlement proposal GM mentioned that the elimination "would be likely to increase competition" as "all 12,000 GM dealer locations would be able to claim wholesale compensation whenever they sold an eligible crash part . . . to an independent auto body repair shop" (ALJX 13G, H, Supp. to CX 7012) (CCPF 257).

108. GM pays wholesale compensation on sales by one GM dealer to another in two situations. The first is when the [24]purchasing dealer is a so-called "country dealer"—a "small dealer in an outlying area" (CX 7813B) who, with advance approval from GM, buys from another GM dealer of the same franchise (CX 7813B; Tr. 2087). The second situation is sales "on an emergency basis", *e.g.,* when a vehicle is "inoperative" (CX 7813B; Tr. 2087) (CCPF 311).

109. The "great majority" of collision damaged vehicles that are repaired can be driven, however, "emergency basis" orders occur frequently, resulting in a considerable number of wholesale compensation payments (Tr. 1576). A purchasing dealer need only state that his purchase is for an emergency for the selling dealer to justify a claim for wholesale compensation (Tr. 10573–74; 11063; 12024–25).

110. GM dealers consider an "emergency basis" to exist when

damaged vehicle is in the shop of the dealer buying the part, regardless of whether the vehicle to be repaired is in fact inoperative (Tr. 9054–55; 11062–63). Neither the selling dealer nor a GMPD field warehouse has the means of verifying whether a sale of crash parts to another dealer is in fact for an "emergency" (Tr. 10357–58; 12024–25). Generally, no attempt at verification is made by the selling dealer (Tr. 11063–64). The purchasing GM dealer alone determines whether there is an emergency (Tr. 2087) (CCPF 312).

111. Between 1972 and 1976, in auditing the wholesale compensation claims of less than 5% of its approximately 12,000 dealers, GM recovered $1,664,194 in erroneous claims (CX 7229). Most of this recovery was due to ineligible sales between GM franchise dealers (CX 7230A, B) (CCFF 313) (RRB 313).

112. GM officials recognize the problem of possible abuse of wholesale compensation on dealer to dealer sales. These officials view wholesale compensation on crash parts as facilitating cheating on the claims and have sought to eliminate payments on sales between GM dealers (CX 7346A). GM's president has expressed concern over the amount of wholesale compensation claimed on dealer to dealer sales in some areas, and in general over the significant amount paid in total on such dealer to dealer sales (CX 7253D–E, *in camera*) (CCPF 314).

113. Inventorying of all crash parts at the dealer level would be uneconomical because sixty-five percent (65%) of GMPD's crash parts sell at a rate of 500 or less each year. Ninety-six percent (96%) of crash parts have sales of fewer than 5,000 units per year or less than one per dealer (Tr. 10084) (RPF 55).

114. In the 1976 hearings before the Senate Commerce Committee, a representative of ASC testified that for then current GM models, after the first six months, and for models up to three years old, parts were readily available in a day or two (ALJX 17, pp. 63–64) (RPF 59). [25]

115. GM dealers have an interest in the repeat purchase of cars and therefore an incentive to insure the availability of parts, even though a particular customer might make his repeat purchase from another dealer (Tr. 15755–56; 10069–70; 8622–23). GM dealers or their employees testified that their new car sales are affected by the availability of crash parts (Tr. 10475–77; 10820–22; 11841).

116. In all but a few remote areas of some counties in the United States, there are two or more dealers in each car line in the sale of GM crash parts. The coverage is such that at least two dealers are within an hour's drive of nearly every populated area in the United States (RX 33A–F) (RPF 65).

117. Some GM dealers selling crash parts over wide areas offer same-day or next-day service within a radius of several hundred miles and impose no minimum order requirement. Some absorb freight costs for orders over $200–$300 (frequently medium or average size orders) and accept returns without penalty, including absorbtion of return freight unless the customer is at fault (Tr. 10835–39, 10844; Tr. 10482–84; Tr. 5527–28) (RPF 70).

118. Approximately five thousand invoices and other evidence of sales issued by 82 GM dealers to the IBS witnesses and the stipulated summaries thereof, indicate that the average price at which these IBSs purchase service GM crash parts was list minus 27% in 1974 and list minus 28% in both 1975 and 1976 (CX 2; CX 5373; Revised CX 5374 - Second Revision CX 5706). By individual trade area, crash parts were purchased at the following discounts off list for the following years:

	AVERAGE DISCOUNT (%)		
TRADE AREA	1974	1975	1976
Buffalo, N.Y.	–	28	29
Mansfield, Ohio	–	26	27
Cleveland, Ohio	26	28	28
New Orleans, La.	27	30	29
St. Louis, Mo.	–	27	28
Spokane, Wash.	26	25	25
Tucson, Ariz.	28	31	26

(Second Revision CX 5706) (CCPF 107). **[26]**

119. Dealers generally sell crash parts for which they do not receive wholesale compensation at a price of list less 25% (Tr. 14019 *et seq.,* 14539–40). They buy these parts at "dealer price", which is list less 40%. Thus, for a noncompensable crash part listing for $100, the dealer buys it for $60 and sells it for $75. The gross profit of $15 divided by the $75 selling price gives him a 20% gross profit margin (Tr. 14022–26) (RPF 82).

120. Dealers receive a stock order allowance of 5% of "dealer price" on all orders placed on bi-monthly stock or PAD orders (Tr. 11548–49). When a dealer buys a noncompensable crash part "on the pad", his cost is list less 40% less 5%. For example on a $100 list part, his cost is $60 less 5% of $60 ($3.00) or $57. If he sold the part for $75, his margin would then be $18 ($75 less $57) divided by $75 or 25% above his cost (RPF 83).

121. If a GM dealer wholesales noncompensated new GM crash parts at suggested trade prices, he realizes a profit margin of 20%

and a mark-up of 25%. If the parts were purchased on stock order (PAD), the gross profit margin would increase to 24% and the mark-up to 31.6% (Tr. 15064, 15067–68) (CCPF 51).

122. Complaint counsel's expert witness, Dr. Steven Nelson, estimates that approximately 50% of crash part orders are on the PAD and subject to the 5% stock order allowance (Tr. 14532). By weighting the margins by the percentage of purchases on and off PAD, dealers' gross profit margin on non-compensable crash parts is 22% (RPF 84).

123. Considering wholesale compensation as a reduction in cost rather than as part of the amount realized on the sale of the part, on PAD orders for an eligible crash part dealers pay 40% of list, less wholesale compensation of 30% of "dealer price", less 5% of "dealer price". Thus, for a $100 list part, the dealer's cost becomes $42, *i.e.*, $100 less $40 less $18 for parts not on the PAD, and $3.00 less or $39 for parts on the PAD (RPF 85).

124. Dr. Nelson estimated that compensable crash parts are generally sold by dealers at prices ranging from list less 25% to list less 40% (Tr. 14019). By taking this range of selling prices, dealer margins on compensable crash parts, again with the 50/50 PAD ratio, may be calculated: **[27]**

Selling Price	Margin, No Pad	Margin, Pad Order	Margin, 50/50 Pad
List less 25% ($75)	44%	48%	46%
List less 40% ($60)	30%	35%	32.5%

(RPF 86)

125. Dr. Nelson testified that approximately 60% of crash parts sold by dealers are compensable and 40% are noncompensable (Tr. 14535 *et seq.*). Factoring the margins for compensable and noncompensable crash parts in this ratio yields the following dealer gross profit margins for all crash parts wholesaled:

Selling Price, Noncompensable Parts	Selling Price, Compensable Parts	Calculation	Margin
list less 25%	list less 25%	.6(46%) +.4(22%) =	36.4%
list less 25%	list less 40%	.6(32.5%)+.4(22%) =	28.3%

Therefore, if wholesale compensation is treated as a reduction in the dealer's cost of the part, dealer margins range from 28.3% to 36.4% (RPF 87).

126. Again using the example of a $100 list part, if the dealer

stocks the part he would have $60 tied up in it while it is in inventory. After the dealer sells the part, whether it is the same day he purchased it or two years later, he receives, under the example, $78. In terms of the amount of money tied up in inventory, his gross profitability in wholesaling crash parts, and the desirability of wholesaling crash parts in relationship to returns available elsewhere upon the investment of $60, it makes no difference to the dealer whether the purchaser of the part hands him the $78 or whether the purchaser hands him $60 and a third party, GM, hands him $18 in wholesale compensation. In either event, he would have had $60 tied up in the part and would not receive the $78 until the part is sold. Therefore, the question is: "How do dealer gross margins compare with margins of other types of wholesalers?" or "How do dealers gross margins compare with margins of other types of wholesalers who say they would need to sell crash parts profitably?". It is only by treating wholesale compensation as part of the income on the sale of the part, that meaningful comparisons can be made (RPF 88).

127. Finally, again relying on Dr. Nelson's testimony that approximately 60% of crash parts sold by dealers are compensable and 40% are noncompensable (See Finding 125), the following are the dealer gross profit margins for all crash parts wholesaled: [28]

Selling Price, Noncompensable Parts	Selling Price, Compensable Parts	Calculation	Margin
list less 25%	list less 25% plus comp.	.6(37%)+.4(22%) =	31.0%
list less 25%	list less 40% plus comp.	.6(25%)+.4(22%) =	23.8%

(RPF 92)

128. Dr. Nelson's calculations regarding dealer gross profit margin ranges on crash parts wholesaling are confirmed by actual GM dealer financial data disclosing gross profit margins on dealer total wholesale parts business. Actual data demonstrate gross profit margins ranging from 25.8% in 1972 to 23.8% in 1977 (RX 301) (RPF 93).

129. If GM chose to sell to them, the most likely candidates for entry into wholesaling new GM crash parts are IWs already selling other products such as auto glass, rechromed bumpers, automotive paint, abrasive, body shop supplies, and salvage parts to body shops. Other candidates would be cooperatives formed by body shops (Tr. 13915–22) (CCPF 193) (RRB 193).

130. IWs generally provide at least one, and often more, free same day delivery on the products they currently sell (Tr. 5463, 5475,

5489–90, 7056–58). IWs believe that they could provide this same service in wholesaling new GM crash parts (Tr. 5480, 6414) (CCPF 232).

131. Some GM dealers, including some large wholesalers of crash parts, do not provide delivery service or provide poor delivery service. Others provide excellent service (Tr. 3812–13; 12050–51) (CCPF 232A).

132. Some GM dealer wholesalers of crash parts use a very limited sales force, and have no sales force to call on their crash parts wholesale accounts (Tr. 3019, 5467). If they have no sales force, orders are solicited and taken by phone (Tr. 2726; 6491) (CCPF 239) (RRB 239).

133. When IWs and GM dealers compete in wholesaling on products such as glass, mufflers or AC-Delco parts GM dealers fare badly in securing such wholesale business or do not attempt to compete with IWs (Tr. 10876) (CCPF 244).

134. IBSs have formed cooperatives which distribute products other than crash parts to their members. For instance Consolidated Automotive Parts, Inc. ("CAPI") is a St. Louis cooperative which has been in existence since 1973 (Tr. 2313). It handles a variety of automotive parts, including sandpaper, paint and crash parts applicable to Porsche, Audi, and **[29]**Volkswagon automobiles. (Tr. 2314). CAPI marks up these items 15% when reselling them to its members (Tr. 2320). One of the reasons for the founding of CAPI was anticipation that GM crash parts would become available to wholesalers such as CAPI (Tr. 2317, 2469, 2471).

135. Many IWs have warehouses, delivery equipment, and personnel that could be used for the storage and delivery of crash parts. For example, IWs currently operate the same types of delivery equipment used by GM dealers who deliver crash parts (Tr. 5409, 5464). Additional personnel, warehouse space, and/or vehicles would pose no problem for IWs (Tr. 2323–24, 6414, 6522, 13915–17) (CCPF 202).

136. Many of the items which IWs sell to body shops are bulky. For example, glass is as bulky as fenders. (Tr. 7666, 7671–72). Windshields are stored in large racks similar to those used for large crash parts (Tr. 11167). IWs also inventory heavy and/or bulky items such as 55 gallon drums of thinner and antifreeze, heavy equipment, spray booths, masking paper, rebuilt motors, salvage crash parts, exhaust system parts, and rechromed bumpers (Tr. 3801, 3823, 5460, 6398, 6423, 6472) (CCPF 206).

137. Several IWs who expressed an interest in entering into the wholesaling of GM crash parts currently stock in excess of 10,000

parts numbers. (Tr. 3803, 5459, 11836). For instance, one wholesaler of mechanical parts, paint, and body shop supplies, inventories over 100,000 part numbers, including some items that "turn" only 1 ½ times a year (Tr. 8846, 8893). Wholesalers of paint and related items and rechromed bumpers may stock 8,000–10,000 parts (Tr. 3803, 5460). Glass wholesalers stock from 2,000 to 6,000 parts (Tr. 5406, 7671–72). CAPI in St. Louis stocks 30,000 parts (Tr. 2322)(CCPF 212).

138. There is little difference in the average speed of movement between the parts stocked by IWs and large GM dealer wholesalers. (Tr. 12022, 12025, 12042). The turnover of crash parts sold by large GM dealer wholesalers is 3.2 to 5 times per year (Tr. 11893, 12042).

139. Interested IWs would be willing to invest "whatever it takes" to get into crash part wholesaling (Tr. 2322, 3050, 4408). For example, a national wholesaler of rechromed bumpers would be willing to invest $2 ½ million to $5 million initially to enter crash part wholesaling (Tr. 7800, 7857), 3039); $500,000 to $1 million (Tr. 3039); $250,000 for initial inventory of crash parts applicable to a single GM car line (Tr. 5473a, 5477) (CCPF 215).

140. IWs have several other incentives to enter into the wholesaling of crash parts. Wholesaling such parts complements their current business (Tr. 4402). IWs could spread their [30]overhead and reduce unit costs by combining deliveries and using their existing sales force (Tr. 6403-04, 6515-16, 7694, 8871).

Crash Parts and Their Manufacture

141. In 1975, GM gross sales of crash parts were in the hundreds of millions of dollars (CX 7407 A, *in camera*). Based on 1977 wholesale compensation payments and a 60% eligibility factor *(i.e.,* the 13,000 parts on which wholesale compensation is paid out of a total of 32,000 crash parts (Tr. 10072)), GM's gross sales of crash parts had increased more than 70% by 1977 (CCPF 46 and 306 - *in camera*) (CCPF 15).

142. Crash parts are sold to a distinct class of customers, body shops which specialize in the repair of crash-damaged vehicles. These shops generally perform very limited mechanical repairs, doing such work only when it is accident related. Consequently, body shops' purchases of automotive replacement parts consist almost entirely of crash parts (Tr. 3059–60, 3835) (CCPF 54).

143. While the storage of some crash parts requires special bins, such bins in general are not unique (Tr. 10997, 11046–47). Many such bins are built to handle a particular type of crash part (Tr. 11046–

48). Others can be used to store either crash parts or mechanical parts (Tr. 11047) (CCPF 204).

144. Normally GM crash parts will not fit or coordinate with vehicles assembled by companies other than GM, and crash parts applicable to non-GM vehicles will not fit or coordinate with GM vehicles (Tr. 1192–94, 1365–66, 1678) (CCPF 56). Crash parts are not standard and usually may be used only for the vehicle for which they were designed (ALJX 9P - Supp. to CX 7006B).

145. Replacement of parts for reasons other than crash damage, such as rust, is infrequent. Also, unlike replacement mechanical or "functional" parts applicable to GM vehicles, crash parts are seldom installed for purposes of maintenance or due to wear or mechanical failure (Tr. 1361–62, 1675, 2260–61; CX 7226B) (CCPF 58).

146. Crash parts account for approximately 70%, both in units and dollars, of all automotive parts replaced under insurance claims for damage to GM automobiles and light trucks (CX 7405; see also CX 7400A–V, CX 7401A–X and Z–3 to Z–36, CX 7402A–H) (CCPF 59).

147. Some GM crash parts can seldom, if ever, be repaired due to their type of construction. For example, parts made of pot metal, such as fender and rear end caps, parts which are chrome-plated, such as bezels, grilles, moldings, and glass components generally are not repairable (Tr. 2501, 3068, 3837) [31](CCPF 62). Parts constructed of plastic, fiberglass, and aluminum are very difficult to repair (Tr. 1729–30, 2501–02) (CCPF 64).

148. Dr. George Benston, GM's expert witness, testified that ownership of the dies used in the manufacture of new cars is the decisive, competitive advantage that GM has over other potential manufacturers of crash parts (Tr. 15747) (RPF 180). Usually there exists a single set of dies which produces both original equipment and service parts. The total cost of dies used in the manufacture of crash parts for a particular vehicle varies greatly. It depends upon the number of plastic rather than metal parts, the number of body styles covered and the amount of use obtainable from tooling for prior model vehicles (ALJX 9S, Supp. to CX 7006).

149. A new model normally utilizes substantial tooling from the prior model which may be completely unchanged or modified to create new lines through the use of inserts. The cost of tooling to manufacture crash parts can run to tens of millions of dollars. This cost stems from producing original equipment as well as service and crash parts for repairs. GM estimates that service parts normally account for less than 15% of the total volume of dollars spent on tooling (ALJX 9T, Supp. to CX 7006).

150. Original equipment and repair parts are often produced

during the same run. They also may be produced on a separate production run, but within the same plant. For these, setup costs (excluding transportation charges) may run to several thousand dollars depending upon the number of dies required for each part and the complexity involved (*e.g.*, 17 separate dies were required for an outer rear quarter panel on the 1976 Chevrolet Impala) (ALJX 9U, Supp. to CX 7006).

151. No evidence was adduced indicating that GM has impeded entry into the manufacture of parts, including crash parts (ALJX 9X, Supp. to CX 7006). Any manufacturer who cares to is free to make GM crash parts (CX 7008).

152. "Total crash parts demand is high, . . . but with possible exceptions, the demand for each individual part is probably quite modest. The probability that a car will require the replacement of a particular fender or other crash part with a new one during its lifetime is not great. One would not, therefore, expect this market to be attractive to potential entrants." (CX 7006E, quoting the Commission's Office of Policy Planning and Evaluation (OPPE), 1975 Semi-Annual Budget Review, Jan. 24, 1975 at p. IW–17).

153. For any one of the thousands of individual GM crash parts, the demand is extremely low—particularly when compared to the number of car models originally produced. For example, [32]between 1968 and 1975, fenders for Chevrolets alone accounted for about 11% of production. The following table, included in a March, 1976, GM presentation at the Congressional hearing mentioned above (Finding 54) shows this in greater detail:

Annual Production Calendar Year	3926836 Hood	3953693 Fender L/H	3953694 Fender R/H	3926848 Front Bumper Bar
1968*	2,711	4,784	4,854	7,431
1969	17,120	25,097	25,331	39,937
1970	16,141	26,371	26,559	31,048
1971	13,917	21,637	21,688	17,228
1972	10,712	17,651	18,435	11,035
1973	7,296	13,397	13,675	7,149
1974	2,544	6,703	7,405	2,975
1975	755	3,614	4,211	1,675
Total	71,196	119,254	122,158	118,478
% of Production	6.4%	10.8%	11.0%	10.7%

*(ALJX 14Z24, Supp. to CX 7014).

154. These figures illustrate one of the principal reasons why other manufacturers have not entered the business of manufactur-

ing crash parts. The replacement parts represented by the table above were built as demand warranted during the lifetime of the vehicle. Neither GM nor anyone else could maintain enough warehouse space to economically produce anticipated crash parts needs, such as those involving these four parts, in one production run. Thus, over the years the dies for these units must be set up and the parts produced as inventory needs demand and warehouse space allows. This adds to consumer costs (ALJX 14Z24, Supp. to CX 7014).

155. The relatively low demand for crash parts is only one factor which has discouraged other manufacturers from making them. There also are the tooling costs. There are economies if the dies that are required for most crash parts are used for producing both original equipment and service parts and such [33]economies are greater when original and service parts are produced during the same production run. Some crash parts have little or no year-to-year variation in their design. Thus, parts of several years past can be scheduled along with current original equipment production. For example, the trunk assembly for the Chevrolet Monte Carlo used some of the same tooling for model years 1973 through 1976 (ALJX 14X, Supp. to CX 7014).

156. GM's Fisher Body manufacturing plants retain dies to make sheet metal parts for models six to seven years old—and in some cases even older. Typically, these dies, which may weigh ten tons and over, are kept in storage yards. The dies are retrieved, steam cleaned, reconditioned—in some cases partially rebuilt—and then inserted into presses to run the required supply of service parts. This is an expensive process because much of it is short-run and labor intensive (ALJX 14Y, Supp. to CX 7014).

How Parts Are Distributed By Gm

157. Parts for GM's vehicles are distributed by General Motors Parts Division (GMPD) and AC-Delco Division. GMPD and AC-Delco are engaged wholly in warehousing, marketing, distributing, and selling parts for GM (Tr. 1994–95).

158. Some parts, such as spark plugs, shock absorbers, radiators, oil filters, fuel pumps, etc., are sold both by GMPD and AC-Delco. Sheet metal parts, which generally includes crash parts, *e.g.,* body frame, chassis parts, interior trim parts, and engine parts are sold exclusively by GMPD (Tr. 2003–04). Batteries are sold exclusively by AC-Delco (Tr. 2011).

GMPD

159. GMPD was established to provide GM car dealers with the parts they need for the make of car they sell (Tr. 1995). GM's profit from distribution of parts had declined due to rises in warehousing and distribution expenses. These had doubled between 1962 and 1968 for the five car divisions (CX 7248B). The number of service parts needed to serve the market had increased from 132,000 in 1955 to 316,000 in 1968 (CX 7248C).

160. Within GM, GMPD is responsible for assuring the availability of parts to service GM cars. Aside from batteries, GMPD sells all parts applicable to GM cars (Tr. 10043–45, 10181, 2012) (RPF 17).

161. From model year 1959 through model year 1970, each car division either manufactured or purchased all crash parts applicable to its make of cars. As of January 1, 1959, the predecessor of the present GMPD, which at that time was a part of Chevrolet Division, was made responsible for warehousing and distributing service parts to Chevrolet, Oldsmobile, and Pontiac [34]dealers. Both Buick and Cadillac had assumed responsibility for the distribution of their own service parts, and maintained their own field warehousing operations. Buick and Cadillac field locations were consolidated into GMPD between 1963 and 1966. However, each car division continued to operate a factory warehouse supplementing the GMPD field distribution centers. Many slow-moving parts, including some crash parts, could be obtained only from those warehouses (CX 7002F).

162. GMPD was made a separate division of GM effective March 1, 1969, and began to assume all procurement and warehousing functions, both field and factory. On September 1, 1970, GMPD became fully responsible for the procurement and warehousing functions. Initially it was not uncommon for GMPD to obtain current model service parts from Fisher Body Division, although Fisher had itself purchased the parts from an outside supplier. By the beginning of the 1973 model year the transition to GMPD had been concluded (CX 7002F).

163. Approximately 65% of the crash parts which GMPD sells are manufactured by allied GM divisions (*e.g.,* Chevrolet, Pontiac, Oldsmobile, Buick, Cadillac, Fisher Body) (CX 7011B).

164. Before GMPD was formed each GM car division had its own warehouse parts plant (Tr. 2039; CX 7248D). At such parts plants additional processing was and still is done on the part before shipment to a dealer, *e.g.,* cleaning, finishing, painting, protective material applied or packaged (Tr. 2039; 10046–47) (RPF 22).

165. Crash (sheet metal) parts, chassis parts, interior trim parts

and engine parts are sold by GM exclusively through GMPD. In addition, parts with GM applications that are sold through AC-Delco are also sold through GMPD (Tr. 2003, 10068, 10271) (RPF 18).

166. GMPD employs about 13,000 persons. The division does not operate manufacturing plants, but buys parts in a finished state from about 2,500 suppliers—both within General Motors and from outside suppliers (ALJX 14Z–21, Supp. to CX 7014).

167. GMPD distributes about 300,000 parts. Of that number, 12,000 are AC-Delco parts with GM applications (Tr. 10271), and about 32,000 are crash parts as defined in the Complaint (Tr. 2209). The remainder, about 256,000 parts are neither crash parts, nor AC-Delco parts (Tr. 14678, 10178) (RPF 19). GMPD makes no distinction between crash parts and other parts (Tr. 10062) (RPF 20).

168. Of the 32,000 crash parts, 13,000 are eligible for wholesale compensation (Tr. 10072). These 13,000 account for an estimated 60% of the dollar volume of sales of GM crash parts (Tr. 14535–36 and see RX 311A) (CCPF 46). **[35]**

169. In 1974–75, GMPD conducted a study of crash parts covering 13,155 separate part numbers. It showed that 23% of the part numbers account for 87% of the sales. The balance, 77% of the total of crash parts, or over 10,000 parts, had sales of less than 700 units a year. The fastest-moving, those with sales of from 600 to 699 units a year, had average dollar sales of less than $5,000 in the twelve months ended May 31, 1975, and an annual rate of inventory turnover of less than 1. Most of the 13,155 part numbers had annual sales of less than 300 units and $2,000 with an annual inventory turnover rate of less than .5. Four percent (4%) of the total, or 537 part numbers had piece sales as high as 5,000 during the year. These sales averaged as high as $40,000 (CX 7006D).

170. GMPD only sells replacement parts to GM passenger car and truck dealers (Tr. 1994). The dealers sell the parts through their own service operation to car owners, to independent body shops, and to other GM dealers (Tr. 1994–95).

171. Currently, GMPD maintains seven factory warehouses ("parts plants") and 36 field warehouses (PDCs). Faster moving parts are shipped to GMPD field warehouses. The slowest moving are held at the parts plants to be shipped directly to GM dealers as ordered (Tr. 2039–40, 10046–47, 10107) (CCPF 17; RPF 24).

172. There are 25 GMPD field warehouses which stock parts for GM automobiles and light trucks (Tr. 10047). These 25 are located in or near major cities of the United States (RX 19C, D). For purposes of placing and receiving orders, the approximately 12,000 GM dealers are assigned to one of the 25 field warehouses, also referred to as

PDCs or parts distribution centers (Ans. ¶ 11; Tr. 2040, 2046; 10047–48) (CCPF 18).

173. This channel of distribution is known as the independent aftermarket (Tr. 12537). There are about 1,000 to 1,500 WDs and over 30,000 jobbers (Tr. 12539; 8640–41). Parts sold in the independent aftermarket are replacement parts, that is, parts that tend to wear and are replaced periodically (Tr. 12490; 12614–15). Generally, there are two or more manufacturing sources for each product line (Tr. 12538). Firms in the independent aftermarket carry parts for most makes of cars (Tr. 12538; Tr. 12633) (RPF 15).

174. The car-part PDCs are: ten "Z" PDCs which carry the 12,000 fastest moving parts; nine "M" PDCs which carry the 12,000 "Z" parts plus "M" parts, which are the 25,000 next fastest moving parts; six "MF" or Master Factory PDCs carry the 12,000 "Z" parts, the 25,000 "M" parts, plus the "MF" parts which are the 28,000 next fastest moving parts (Tr. 10048) (RPF 25). **[36]**

175. Of the 300,000 different parts in the GMPD system, approximately 225,000 or 75% are "F" parts. Of the 32,000 different crash parts, approximately 56% are "F" parts (Tr. 13905). Of the 25 field warehouses, six are "MF", nine are "M", and ten are "Z" (RX 19A–D; Tr. 10045–46) (CCPF 20).

176. The PDCs sell to the GM dealers (RX 19; Tr. 10043, 10045–46). When a dealer places his order with his assigned PDC, a computer discloses where the part is available and, if necessary, refers the order to the nearest PDC or to a parts plant (Tr. 10090–97, 10099–100) (RPF 29).

177. GMPD's order fill rate, *e.g.,* the percentage of items ordered which are in stock at the point of initial order, was 95% for the 1978 model year (Tr. 10061) (RPF 30). In contrast, a GM dealer rarely can fill an entire order for crash parts from inventory (Tr. 3162, 3272, 5956–57).

178. Most IBS complaints involve low-demand, slow-moving parts (Tr. 1866, 6982–83). GM dealers generally stock the fast-moving "Z" parts which constitute about 8% of all GM part numbers, and these dealers only stock the "Z" parts which are applicable to their franchise line (Tr. 10242–44).

179. Many GM dealers rely on the GMPD warehouses or another dealer as the primary source of stock for crash parts rather than carry their own inventory (Tr. 6520).

180. Parts plants stock the bulk of all parts, including the slowest moving and older parts. In general, the parts plants supply the PDCs, not dealers. However, the dealers are supplied very slow moving parts and some special-order parts from the parts plants. For

these slow moving parts, which are stocked principally at the parts plants in Michigan, GM uses air shipment. Dealers normally are supplied from the PDCs. The PDCs receive the parts from parts plants and from manufacturers (Tr. 2040). [37]

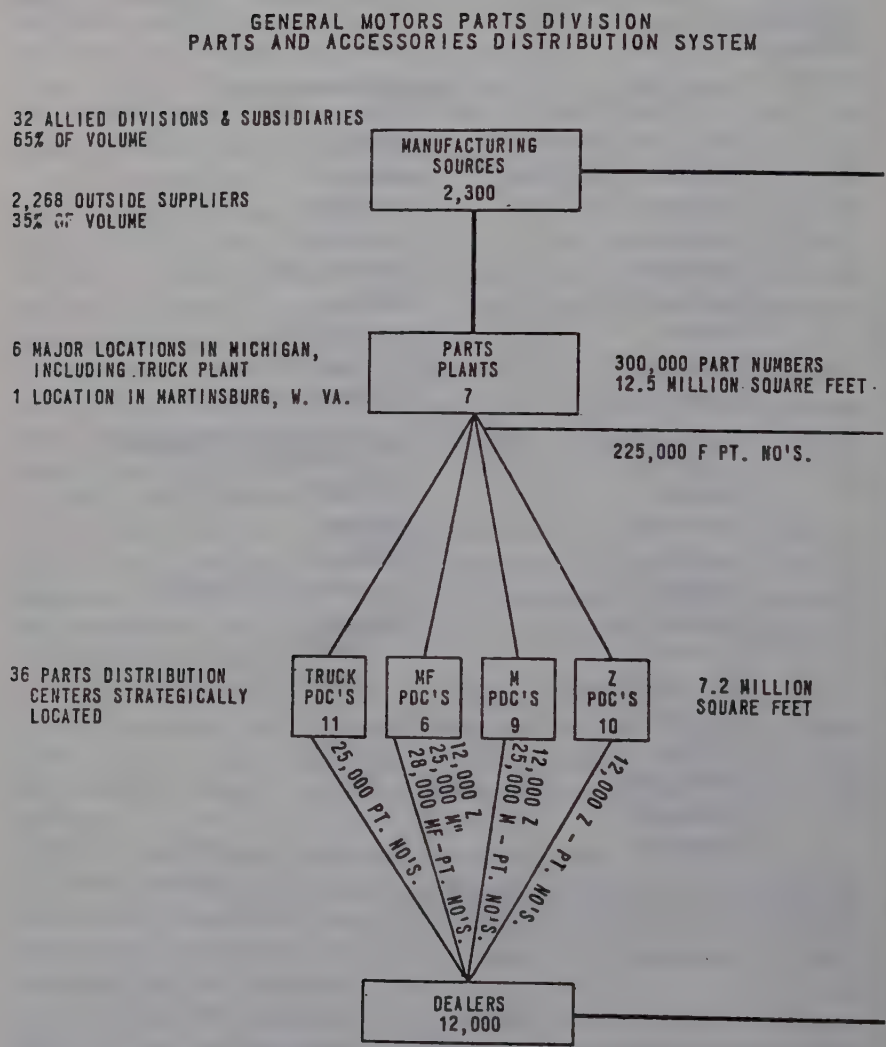
181. The following shows the geographical locations of these GMPD facilities:

Parts Plants (6)	Master PDCs (9)
Flint (Complex = Plant 01, 02, 03, Grand Blanc and Toledo)	Baltimore
Martinsburg	Boston
Drayton Plains	Cincinnati
Pontiac	Denver
Lansing	Jacksonville
Detroit	Livonia
	Los Angeles
	Minneapolis
	Portland

Zone PDCs (12)	Master Factory PDCs (6)
Buffalo	Atlanta
Cleveland	Chicago
Houston	Dallas
Indianapolis	Englewood (Newark)
Kansas City	Oakland
Louisville	St. Louis
New Orleans	
New York	
Omaha	
Philadelphia	
Pittsburgh	
Richmond	

(ALJX 14Z–22, Supp. to CX 7014) [38]

182. The following diagram shows the system more graphically (RX 19).



AC-Delco

183. AC-Delco maintains seven field warehouses and stocks 60,000 part numbers consisting of over 30 product lines. These lines include spark plugs, filters, carburetors, fuel pumps, wire and cables, seal beam units, shock absorbers, and ignition parts. AC-Delco sells to approximately 3,000 customers. These consist of WDs who sell to jobbers and occasionally to the customers of jobbers such as independent garages, gasoline stations, and car dealers (Tr. 1995–96, 2003, 2050–51, 2210) (CCPF 10).

184. AC-Delco also sells to national accounts such as Firestone Tire & Rubber Co. and Montgomery Ward & Co. (Tr. 1995). Some WDs make some sales to GM dealers (Tr. 1996), however, GM dealers are not permitted to buy parts directly from AC-Delco (Tr. 2001).

185. AC-Delco parts are generally items that can be used on both GM and non-GM cars (Tr. 2015-16, 2230-32). Basically they are parts that are required in the maintenance of the car, *e.g.,* spark plugs, filters, shock absorbers, points, condensers, bulbs, headlamps, fuel and water pumps. (Tr. 10183).

186. With few exceptions, crash parts, as defined in the complaint, are not AC-Delco parts (Tr. 2003–04) (RPF 13).

Chrysler's Mopar Parts Distribution Experience

187. Before the early sixties, Chrysler sold its parts from five or six Chrysler-owned plant warehouses to 10 (in 1963) independently owned Mopar wholesalers who resold the parts to Chrysler dealers and other retailers (RX 21Z–50) (RPF 111). In the early sixties, Chrysler began phasing out the Mopar wholesalers and replaced them with 13 or 14 Chrysler-owned field warehouses. It also divided its parts into two groups and began selling them in two separate channels. All parts applicable to Chrysler cars were sold directly to Chrysler dealers. Single source parts, including crash parts, were sold to the dealers exclusively. Parts not applicable to Chrysler cars were not sold to the dealers. In other words Chrysler switched to a system like GM's (Tr. 8486–88, 8494) (RPF 112).

188. The system that Chrysler discarded is similar to the one which the order proposed in the Complaint would establish. Chrysler spent $53 million to change to a system like GM's. Chrysler has not chosen to switch back. Chrysler's choosing not to switch back is significant because as Dr. Benston, GM's economist witness, noted, Chrysler is: [39]

now in a position of selling off assets, of contracting their operations. The simple

thing, it would seem to me, for them to do would be to sell off this whole system, sell off the warehouses, disband the system, go back to the old system and have a better way of serving consumers for their own benefit or saving resources or something else. They are selling off a lot of things. They are not selling off their warehouses, they are not shifting to independents, to my knowledge. I can't think of any better evidence that people who have had previous experience with another system are in a position of wanting to disband some part of their operations, choose not to disband that part of their operations. (Tr. 15818–19) (RPF 119).

189. The $53 million cost that Chrysler incurred in the 60's is an indication that the costs of changing GM's system would be high. Inefficiencies created by changing the system would add costs which would be passed on, ultimately, no doubt, to the consumer/car owner (Tr. 15734). There also would be a cost to the car owner if parts became less available (Tr. 15735) (RPF 125).

Ordering Methods

190. There are four principal ways GM dealers order crash parts from GMPD:

1. The Stock Order (PAD order) is for routine restocking. Each dealer has an assigned day every two weeks on which he can place his stock order (Tr. 10053; 10461-64). Parts are shipped within two days of the receipt of the order (Tr. 10053). Dealers receive a five percent (5%) additional discount on such orders. This is because such orders enable GMPD to fill large quantities per order at convenient times; however, the saving is not translatable into specific cost savings (Tr. 2078–80; Tr. 10072–74, 10232–34, 10236, 10238–39) (CCPF 22). GM prepays the freight charges on PAD orders (Tr. 2079). Neither a minimum inventory nor a minimum dollar amount or number of units need be handled to qualify for the 5% stocking allowance (Tr. 2080).

2. The Supplemental Stock Order (SSO). These orders may be placed at any time (Tr. 10054). Parts ordered in the morning are to be shipped out the next day. Parts ordered in the afternoon are to be shipped on the second day after the day of the order (Tr. 10054, 10108). No minimum order is required (Tr. 10056, 10357–58). GM prepays the freight on such orders (Tr. 2081) (CCPF 24).

3. Car Inoperative Order (CIO). This order is used when a car is inoperative because of a lack of parts. GM prepays the [40]freight (Tr. 2081). A CIO order has priority at GMPD ahead of Stock Orders and Supplementary Stock Orders (Tr. 10056–57).

4. Very Important Part (VIP). The VIP order receives top priority, may include a search of all warehouses and going to the

manufacturer of the part. The dealer pays the freight (Tr. 2076–77, 1082–83, 10058–60, 10109–11) (RPF 31).

191. CIO and VIP orders may be used by any GM dealer at any time, regardless of whether that dealer stocks or not, to obtain service GM crash parts for use in the dealer's own body shop or for resale to IBSs (Tr. 11911–12, 12073–74). A GM dealer may rely solely on CIO and VIP orders to obtain service GM crash parts (Tr. 12074) (CCPF 228); however, GM imposes a surcharge of two dollars plus 5% of each line item price on such orders (Tr. 10057, 10109–11, 11264–66) (RRB 228).

192. GM parts specialists hold that a well run parts department will order parts on the following basis: 80% PAD, 15% SSO, 5% CIO or VIP (CX 7332C). GM officials have stated that dealers near a field warehouse do not order enough parts on their bi-monthly stock orders (PAD) because they can get the part immediately on a CIO basis. In short, it simply does "not pay a dealer near a warehouse to stock crash parts" (CX 7332C).

193. Orders are filled at GMPD warehouses in the sequence of VIP and "will call" first, followed by CIO, SSO, and PAD in that order (CCPF 22–25; Tr. 8009). GM officials have stated "GMPD needs more PAD and less CIO" and "wholesale compensation is being abused" in that it is being paid to GM dealers with little stocking done in return by the dealers (CX 7355B).

194. Some warehouses limit "will calls" to certain hours (Tr. 2084–85). GMPD's Baltimore warehouse, to which 377 GM dealers are assigned, can handle up to 60 dealer "will calls" a day. This is so even though dealers seldom pick up during evening hours (Tr. 2084–85, 10398–99, 10401, 10411). The purpose of "will call" orders is to satisfy dealers urgent requirements or, in some instances, to permit direct delivery to a wholesale customer (CX 7238E) (CCPF 26); however, most GM dealers prefer to receive shipment by common carrier, with freight prepaid by GM (Tr. 10423–25) (RRB 26).

195. At the Baltimore warehouse, a master PDC, PAD orders account for 46% of the orders, CIOs 30–31%, SSOs 14%, VIPs 1 ½% and will calls 7% (Tr. 10436–37) (CCPF 28 & 229) (RRB 229).

196. Except for VIP orders and will calls, GMPD generally ships parts to dealers in trucks. Truck shipments occasionally take over 24 hours to reach some dealers, although not those dealers located within the metropolitan area of the warehouse. If the shipment is from a warehouse to which the dealer is not assigned, transit time may exceed two days (Tr. 10097–99; 10408) [41]

GM Parts Pricing and Monitoring

197. GM suggests to its dealers a wholesale price of list less 40%, for compensable crash parts and for noncompensable parts list less 25% (Tr. 10071–72, 10253–54) (RPF 35).

198. GM has not and does not control or monitor: (1) the price dealers charge wholesale customers for crash parts; (2) the territory in which they sell; or (3) the types or classes of customers to which they sell. GM dealers do not have any exclusive right to wholesale crash parts in their franchise line in particular territories (Tr. 2090, 10666–67, 11022–25) (RPF 37).

199. GMPD, in submitting recommended prices for crash parts to the GM officials responsible for the decision, includes comparisons with the prices of similar parts for competing manufacturers' vehicles (Tr. 10291; CX 7228A–H). Witness Daly, who was employed by Chrysler, also considered competitive manufacturers' prices in pricing Chrysler crash parts (Tr. 8651) (RPF 52).

Insurance Companies and Crash Damaged Vehicles

200. Approximately 90% to 95% of all business done by both IBS and Dealer Auto Body Repair Shops ("DBS") is paid for by insurance companies (Tr. 1872, 2399) (INPF 1). This is not likely to decline due to the growing number of state mandatory insurance laws. As a consequence, obtaining insurance-paid business is crucial to body shops (Tr. 2297, 3857) (CCPF 127). For almost all purchases of crash parts the real consumers ultimately are insurance companies (Tr. 1872) (INPF 20).

201. Since 1970, the major casualty insurance companies have substituted in most instances for the two or three appraisal system a system of cost control in obtaining estimates in connection with their paying for repairs of crash damaged vehicles (Tr. 4309–11). Under the two or three appraisal system IBS and DBS auto body repair shop personnel make the estimate and arrive at their own prices for insurance-paid business (Tr. 4314) (INPF 2 & 3). Under the cost control system insurance company appraisers and/or drive-in appraisal centers operated by the insurance company are used to prepare the estimate and arrive at the price. This gives insurance companies more control over the prices they pay for the repair of crash damaged vehicles (Tr. 4315) (INPF 5 & 6).

202. Primarily in rural areas, where drive-in claim centers do not exist and on-site appraisals by company or independent appraisers are inconvenient, some companies still operate on a competitive bid system. Under this system, the customer secures **[42]**several esti-

mates (usually 2 or 3) from body shops and if he does not have a preference for a particular shop, quality of work considered, the company will then refer him to the body shop with the lowest estimate (Tr. 1575–76, 1682) (CCPF 129).

203. In writing appraisals for the repair of crash damage, insurance companies: (1) use standard "crash manuals" to determine the time to be allowed to repair the vehicles (Tr. 1439); (2) use the "prevailing" or "going" labor rate in the area (Tr. 1450–51) and; (3) use the "prevailing" or "going" discount in the area on crash parts (Tr. 1451, 1452, 1453). Normally, these are determined by the insurance companies (Tr. 5169, 2410, 7624) (INPF 6–9).

204. For claims settled directly with the insured, appraisers for most insurance companies, whether they are at a drive-in claim center or in the field, will normally calculate the estimate using parts discounts extended by body shops in the area (Tr. 1218, 1319) (CCPF 130).

205. Most insurance companies, including the largest ones such as State Farm, Allstate, Farmers Group, Safeco, Liberty Mutual, Nationwide, and Grange, designate certain body shops as "preferred", "one-stop" or "competitive" (RX 288; Tr. 1219, 4844, 5797). Such shops generally are those which have agreed in advance with the insurance company to accept jobs at an agreed-upon parts discount and, sometimes, labor rate. A preferred shop will normally accept the insurance company's estimate without first seeing the vehicle and preparing its own estimate (Tr. 1221, 1322, 1324) (CCPF 132).

206. Usually neither an IBS nor DBS will have insurance-related work referred unless the shop management has agreed to do that work both at the "prevailing" labor rate and the "prevailing" discount rate (Tr. 1450–51, 1452, 1453, 1836–41) (INPF 13).

207. A very sizeable portion (80%) of insurance-paid work on crash damaged vehicles is performed by body shops to which the claimant is referred by the insurance company (Tr. 6862–63).

208. In St. Louis, Cleveland, and Tucson, virtually all IBSs and DBSs extend a parts discount on insurance work. In these areas, GM dealers offer a discount of at least 10%, and frequently more, up to as much as 25% on bumpers (Tr. 1843, 8277) (CCPF 138).

209. In New Orleans, Buffalo, and Spokane, only some IBSs give a 10% parts discount while all GM dealer body shops extend discounts of at least 10%, and as much as 20% to those insurance companies that refer the most business (Tr. 3117–18, 3156, 3651–54, 3657, 7363–64, 7915). In Mansfield, Ohio, discounts are given by GM dealer and independent body shops only as included [43]in the

estimates prepared by adjusters in referral situations. However, GM dealer body shops successfully attract most of the insurance business by submitting lower bids (Tr. 6595–96, 6610–11) (CCPF 139).

210. Failure to match GM dealer discounts results in IBSs losing insurance-paid business to GM dealers (Tr. 1325, 2301–04, 3655, 3660–61) (CCPF 141) (INRB 141).

211. In some instances, IBSs match the discounts offered by GM dealer shops to obtain insurance company referrals. If they do, the IBSs get their fair share of referral work (Tr. 6675–76) (CCPF 142).

212. Some IBSs could not continue in business if they were to meet the discounts GM dealer shops give to insurance companies (Tr. 2851, 3653–54, 4212). Al's Body and Fender Repair in Spokane, Washington, for example, used to give a 10% discount to insurance companies but soon found it had "too slim a margin" and so couldn't afford to continue it. Today Al's gives no parts discount but in so doing loses considerable volume. Because he competes with GM dealers who give 15–20% parts discounts to insurance companies, Al's gets no GM referral work. Consequently only about 10% of his business is on GM vehicles (Tr. 7363–66) (CCPF 145).

Repair or Replace with New or Used Parts

213. When a motor vehicle is crash damaged the owner has several options. A new replacement part may be installed or the damaged part may be repaired or replaced with a used part. Some parts may be replaced with a partial panel not manufactured by the new vehicle supplier. Also, the repair may not be made or, if the damage is extensive, the vehicle may be scrapped. If it is, additional used parts become available (CX 7006B).

214. Salvage crash parts are used crash parts obtained from wrecked vehicles (Tr. 1385, 1731). Salvage yards purchase wrecked GM vehicles, disassemble them and wholesale the salvageable GM crash parts to body shops (Tr. 1908–10, 4415) (CCPF 68).

215. A survey was conducted by GM in 1974 of thirty-one automobile body repair shops in Fort Wayne, Indiana. The operators of the shops estimated that in fifty percent of all instances of crash damaged vehicles, original parts were repaired and reused (CX 7006B–C). The repair rather than replacement of parts on crash-damaged GM vehicles has been decreasing in part due to changes in vehicle construction (Tr. 2501).

216. Recent year GM automobiles and light trucks contain more and more crash parts made of fiberglass and aluminum to [44]reduce weight and thereby meet federal mileage requirements (Tr. 1265–66,

1384, 1729–30) (CCPF 65). The repair of fiberglass crash parts poses a health hazard and is, therefore, disfavored by body men (Tr. 2501).

217. Frequently parts are replaced when they could be repaired at lower cost. This is because:

(1) Owners may insist on new parts—especially on newer cars—even though a repaired part would be satisfactory;

(2) Some repair shops work almost exclusively on a high volume basis and can process more jobs by replacing parts than by devoting the time to repairs—even though the cost saving to insurers and consumers could be substantial;

(3) In some cases, body repair shops do not or cannot employ persons possessing the necessary skills to repair rather than replace;

(4) The insurance adjuster may not have been sufficiently trained to recognize how parts can be repaired and to understand the cost equation of repair versus replacement. Lacking this practical knowledge, he may be unable to obtain the insured's agreement to repair the part rather than replace it (ALJX 14Z–6, Supp. to CX 7014).

218. Insurance companies have fostered and continue to foster the installation of used or salvage parts (Tr. 1764, 1246) (RPF 191). Allstate recommends used parts whenever possible to avoid total losses (Tr. 1247). Travelers requires used parts installation, regardless of consumer opposition, whenever possible and economical, including on current models (Tr. 1510–11) (RPF 192).

Salvage Parts

219. Unlike GM dealers, salvage yards and bumper rechromers tend not to specialize in the sale of parts for only one make of vehicle (Tr. 1243–44, 1400) (CCPF 71).

220. Salvage yard operators and rechromers consider their respective businesses to be separate industries from the wholesaling of new GM crash parts (Tr. 1947) (CCPF 73).

221. Far more new GM crash parts than salvage GM crash parts and rechromed GM bumpers are used in replacing damaged portions of GM automobiles and light trucks. On claims paid by leading insurance companies for crash parts applicable to GM cars and light trucks, approximately 75%–90% of the dollar [45]amount paid and approximately 85% of the units obtained are for new rather than used GM crash parts (CX 7400H–I, CX 7401A–D, W, CX 7403, CX 7405; Tr. 1243–49, 1399–1400, 1568).

222. Several of the parts most frequently needed to repair crash

damage, such as exterior moldings, grilles, fender and rear end caps, bumpers, and lamp assemblies are seldom available as salvage. This is due in part to the difficulty of removing them from wrecks and/or the unacceptable condition in which such units are found on wrecked vehicles (Tr. 1392–93, 1938–39). Other salvage crash parts which seldom are utilized include rocker panels, wheel opening panels, and quarter panels (CX 7400H; CX 7401A–V) (CCPF 79).

223. In general, salvage crash parts are only available as part of an assembly rather than as individual parts. In other words, salvage yards generally decline to sell individual crash parts from a front end, rear end or door assembly, preferring to sell the entire unit (Tr. 1240, 1391, 1734–35). A front end assembly usually includes the front bumper, grille, left and right fenders, hood, lamp assemblies, and moldings. A rear end assembly usually includes the left and right quarter panels, trunk lid, rear body panel, lamp assemblies, moldings, and rear bumper. A door assembly will usually include the door skin, door hardware, and door inner panel (Tr. 1239–40, 1390–92, 1734–35).

224. Vehicle owners and body shop operators strongly prefer new over used crash parts (Tr. 1251–52, 1255). Some body shops use salvage crash parts and rechromed bumpers only when there are no new crash parts available (Tr. 4506–08) (CCPF 86).

225. Salvage crash parts are often bent, rusted, previously repaired, scratched, or otherwise damaged, and in need of removal of old paint. The outside storage of salvage crash parts alone results in their deterioration. Thus, it is frequently necessary to trim salvage crash parts by cutting off unnecessary material and otherwise to expend extensive labor to refurbish them prior to use (Tr. 1396–97, 2267–68) (CCPF 88).

226. If the price of a salvage crash part approached that of a new crash part, a body shop would buy a new part if it were available (Tr. 2510) (CCPF 93).

227. The price charged for any given salvage crash part is primarily a matter of supply and demand, the salvage yards' cost of acquiring the part, and the condition of the part. Consequently, the price of any particular salvage crash part may fluctuate widely. Prices change frequently and vary from one year to the next. Due to the condition of the part the price may vary on a salvage yard lot for the same model year. Unlike GM crash parts there are no set or published prices or price lists for salvage GM crash parts (Tr. 1259–60, 1262, 1925–27, [46]1945, 1948–49) (CCPF 95).

228. Almost without exception the price trend over time is exactly the opposite for new crash parts and salvage crash parts.

Prices of new crash parts increase as the vehicles they fit become older, while the prices of salvage crash parts fall rapidly with time (Tr. 1748–49, 2511–12, 2514) (CCPF 97).

229. As a consequence of consumer preferences and increasing price disparity over time, salvage GM crash parts are utilized less frequently on the most recent GM vehicles. They are used increasingly as the vehicle becomes older, in part, to avoid "totalling", *i.e.,* not repairing the vehicle. In contrast, new crash parts are utilized almost entirely on newer models and are used less frequently as the vehicle ages (CX 7401 Z9–Z26, Tr. 1246) (CCPF 100).

230. State Farm, the world's largest automobile casualty insurer (Tr. 1667), has actively encouraged the use of used parts. At all times State Farm stresses consideration of used parts, including salvage assemblies and rechromed bumpers (RX 200G, RX 212D, RX 223A). If it costs less to replace with salvage parts and they are available, State Farm prefers salvage over new (Tr. 1764, 1792). If there is a substantial cost difference between new and used crash parts, State Farm makes a settlement offer based on used parts, even though consumer preference is for new, and does so even for current and recent models when used parts are available (Tr. 1791) (RPF 194).

231. Salvage yards have made used GM crash parts more readily available by use of long distance telephone and Telex lines to other yards and published parts locators (*e.g.,* RX 228; RX 236), enabling them to locate and obtain salvage parts on a national basis if they are not stocked locally. Even current model GM crash parts may be obtained from salvage yards on a 24-hour basis (Tr. 9928–29; RX 138M, RX 273A). The long line system is like a conference call. It has speakers on which one person may speak to everyone else on the line (Tr. 1927).

232. Manuals, such as those published by Mitchell's and Hollander, assist salvage operators in determining which parts are interchangeable for which vehicles (Tr. 1964–65) (RPF 200).

233. The salvage industry has had some success in persuading body shops to use salvage parts (Tr. 1968–69).

234. Rechromed bumpers also compete with new bumpers, are priced relative to new bumpers, and are easy to install (Tr. 7795–96) (RPF 201).

235. Availability of salvage GM crash parts may vary by model year. After the second model year they are more available (CCPF 98) (Tr. 3603, 1386–87). A salvage yard's most frequent [47]sales are of parts after the second model year. For example, in 1976, about 91% of witness Arnold's parts sales were for cars older than two years (Tr.

1930–31) (RPF 203). Those needed for the less popular GM models are seldom in good supply (Tr. 1249–50, 1389–90) (CCPF 80).

236. The prices of new and salvage GM crash parts are related and new and salvage GM crash parts are competitive with each other (Tr. 1523, 1861). Usually the list price of salvage parts is expressed as a percentage of the list price of the comparable new part, although the percentage factor may vary with the model year of the vehicle (Tr. 2782, 1950–51). As new parts prices escalate, the prices of used parts tend to follow (RX 278F, G) (RPF 205).

237. An Aetna study of repairs paid for indicated that 23.6% (dollars) of GM crash parts purchases were for salvage parts (Tr. 1546). A similar State Farm survey disclosed that 28.6% (dollars) were for salvage parts (CX 7400; Tr. 1590–91) and a study by Travelers indicated that the figure was approximately 24% (dollars) (Tr. 1493–94, 1497) (RPF 209–11).

238. Dr. Benston testified that used crash parts are one of several substitutes for new crash parts (Tr. 15748, 15775). Also, it is stated in an FTC staff memorandum (1973 Annual Planning Report) that new crash parts "are in competition with recycled crash parts and in some cases, with repaired parts" (RX 51L) (RPF 213).

239. The dollar volume of used automotive parts sold annually is substantial. In a 1969 study, the U.S. Commerce Department, Business and Defense Services Administration, estimated that nationally the used parts industry provides $4.5 billion in replacement parts annually, about one-third the dollar value of replacement parts consumed by the automotive aftermarket. (These parts would be valued at $15 billion new.) Half of these used parts are consumed by the repair trade (RX 138G, R). Mr. Arnold testified that about 40% of this figure would be crash parts ($0.9 billion), and about 63% of those crash parts would be for GM vehicles ($567 million) (Tr. 1953–54).

240. GM's Motors Insurance Company subsidiary stresses repair over replacement of damaged crash parts (Tr. 3934) as does GM (ALJX 14Z-3, Z-6 and Z-7, Supp. to CX 7014) (RPF 217).

241. Of Allstate's total losses, almost fifty percent of damaged GM crash parts are repaired rather than replaced (Tr. 1265). State Farm studies indicated that parts are repaired rather than replaced 40% to 50% of the time (Tr. 1730) (RPF 220).

242. State Farm has calculated that 43% of the damaged [48] parts (units) including bumpers and exterior moldings covered by its policies are repaired rather than replaced (CX 7400H). Bumpers are replaced by used bumpers 60% of the time in terms of dollar volume of replaced parts (CX 7400L). By excluding bumpers and exterior

moldings from CX 7400H, the extent of repair (units) becomes 58% (RPF 221).

Why Have Prices of Crash Parts Increased?

243. The upward trend in crash parts prices is not solely due to GM's decisions to raise prices because of factors related to profitability. For example, on March 12, 1976, the 1972 Chevrolet Chevelle front and rear bumper parts had a combined list price of $146. The list price of the 1975 Chevelle bumper parts on that date was $417. Of the total $271 difference, $244 was due to the addition of bumper parts which were required to meet the federal bumper safety standard. More details are shown in the table following:

GENERAL MOTORS CORPORATION
BUMPER PARTS PRICE COMPARISONS
CHEVELLE: 1972 VS. 1975 MODEL

Bumper Part Description	Parts List Prices March 12, 1976			
	Chev.	Chevelle	Difference	
	72 Model	75 Model	Amount	Percent
	$	$	$	%
Front Bumper Face Bar	78.25	82.25	11.00	14.1
Front Bumper Reinforcement	—	101.00	101.00	xx
Front Bumper Energy Absorber	—	21.20	21.20	xx
Rear Bumper Face Bar	67.75	83.25	15.50	22.9
Rear Bumper Reinforcement	—	101.00	101.00	xx
Rear Bumper Energy Absorber	—	21.20	21.20	xx
TOTAL	146.00	416.90	270.90	185.5

(ALJX 14Z17, Supp. to CX 7014)

244. The bumper reinforcement and energy absorbers required on the 1975 Chevelle were not required on the 1972 model, which accounts for much of the increase in price. As federal bumper standards become even more stringent in 1979–1980, the crash parts costs for bumpers probably will increase further (ALJX 14–H, Supp. to CX 7014). [49]

245. Between September, 1971, and March of 1976, GM service-part prices increased approximately 37%, while crash parts, taken as a specific category, rose 35%. During approximately this same period, the price of steel mill products, from which many crash parts are made, rose 58% and GM's average hourly labor costs rose 51%. The cost of paper products, which figure importantly in the packaging and distribution of service parts rose 67%. Rail transpor-

tation, another significant cost in the parts business, went up 51%. The composite index of industrial commodities rose 55% (ALJX 14K, Supp. to CX 7014).

246. In the mid-70's there was an advertising campaign and representations were made by insurance company representatives to a congressional committee holding hearings on the cost of crash parts that the cost of replacing all the parts to completely repair a 1973 Chevrolet could range up to $24,000. It was not clear that the $24,000 was for parts and labor. GM responded that individual parts always involve far greater costs than finished consumer goods in unit packaging, stocking, cataloging, inventory expenses, obsolescence, and shipping to provide availability. As with most, if not all, manufactured products, the cost of buying and installing the individual parts of a car one at a time would be significantly higher than the cost of a production-line-assembled new car or product (ALJX 14L, Supp. to CX 7014).

Does GM's Method of Selling Crash Parts Discriminate Against IBSs?

247. Most IBSs perform repair work on all makes of cars and light trucks, including foreign-make vehicles. However, due to the large number of GM cars on the road, work done on GM-made vehicles accounts for a significant amount of the potential volume for IBSs and generally for a significant amount of their actual receipts (Tr. 5222–23). Formerly, work on GM vehicles constituted a greater percentage of IBSs' business than it does today (Tr. 2599) (CCPF 123).

248. On purchases of crash parts from GM dealers, IBSs pay an average of approximately list minus 22% on noncompensable and list minus 32% on compensable parts (Tr. 10,520, 14,521). On non-PAD orders, GM dealers pay list minus 40% and on PAD orders list minus 43% for both compensable and noncompensable crash parts (RX 311A; Tr. 14515–16) (CCPF 43).

249. Dr. Nelson testified that these averages show that there is a 15.7% average price differential between what IBSs and GM dealers pay for new service GM crash parts on the basis of his estimate that 60% of the purchases are of compensated parts and that 50% of the GM dealer purchases were on PAD (Tr. 14536, 14560–62).

250. Dr. Benston testified that a comparison between the **[50]** total cost incurred by each, not just a comparison between the invoice prices paid, is a way to determine whether IBSs are at a cost disadvantage in competing with GM dealers (Tr. 16109).

251. Dr. Nelson testified that a wholesaling GM dealer would not resell at his cost to buy a part, that a dealer who transfers a part from his warehouse to his own body shop has real world costs allocable to the transfer and needs a minumum gross margin of 20% (translating to 25% mark-up over cost) to stay in business (Tr. 14469, 14920–23) (RPF 126).

252. The time it takes for an IBS to receive a crash part differs widely depending on whether the part is in the inventory of the dealership from which the part was ordered. If it is in inventory, it may be as little as one hour or as much as 24 hours until delivery (Tr. 2381, 2451–52, 4044, 11131–32, 10644–46). If a part is not in the dealer's stock delivery time depends on whether another local GM dealer has the part, as well as the proximity of the nearest GMPD warehouse. In warehouse cities such as Buffalo, St. Louis, Cleveland, and New Orleans (RX 19C), it may take three days for IBSs to receive parts ordered by the dealer from the local GMPD warehouse (Tr. 4801–02, 7503) (CCPF 114) (RRB 114).

253. The parts departments of GM dealers perform services in wholesaling crash parts to both their own body shops and IBSs. The services performed include ordering, receiving, and maintaining inventory (and obtaining non-stocked parts from other dealers or from GM warehouses), labor in stocking and picking parts from shelves for orders, delivery, order taking and interpretation, billing and record-keeping (Tr. 11018, 11035, 11988–89, 10449–54, 10473–75).

254. Costs associated with the inventorying function include labor to receive, store, pull (remove from stock), and load parts, financial costs for investment in inventory, as well as the cost of facilities to house the parts, insurance, and equipment to store and move them. (RPF 128).

255. There also are costs in servicing IBSs such as billing costs, the costs of extending credit, including credit checks, uncollectable accounts, and money tied up in receivables (Tr. 10846, 10487–88). There are also vehicle and driver expenses for free delivery, and counter service expense (Tr. 11221–22; 10663) (RPF 130).

256. GM financial studies indicate that the national average of dealers' parts and accessories departments' direct and allocated total expenses is approximately 25% of the purchase price of all parts. Between the years 1970 and 1975, dealers' parts and accessories departments total expenses ranged from 22.6% to 25.3% of the cost of sales (RX 35;Tr. 11421–22) (RPF 132). **[51]**

257. For warranty repairs, where GM pays for the part, GM pays

its dealers cost (dealer net) plus 30%. This permits the dealer a profit of roughly 5% (Tr. 11430–31) (RPF 133).

258. NADA studies have disclosed that dealer overhead in parts wholesaling is between 30% and 37.5% of the cost of the parts and that there was a need for GM to increase wholesale compensation (Tr. 8187-88; See also, ALJX 17, p. 95).

259. Mr. Daly, the former Chrysler official, said that a 25% to 27% margin is required to cover costs of handling crash parts at the wholesale level (Tr. 8667) and that a fair dealer markup over cost would be 25% to 33.3% (Tr. 8684) (RPF 134).

260. GM dealers generally mark up crash parts sold or transferred to their own body shops at 25% over the cost of the parts. This is an accounting practice recommended by GM (Tr. 11420–21, 4753). In contrast to the warranty reimbursement of 30%, the GM recommended transfer price of adding 25% to dealer net for parts moving from the parts to the body shop departments does not include a profit (Tr. 11430-31). A GM official estimated that 60% to 65% of all GM dealers use the 25% transfer price (Tr. 11424). Some GM dealers use a 30% markup (list minus 22%). (Tr. 10491) (RPF 135).

261. When the average cost of the wholesaling function which dealers perform for themselves, as measured by the GM recommended transfer price (25% of dealer net, no profit), or the warranty reimbursement (30% of dealer net, 5% profit), is added to the average purchase price of the part to the dealer, the total cost of the parts installed by dealers averages from about list less 27% to list less 24%. These figures are obtained in the following manner. In order to determine the average purchase price of a part, the allowance must be taken into account. About 50% of crash part orders are on the PAD (Tr. 14532 *et seq.*). With half of the order at dealer net (list less 40%, or 60% of list), the average purchase price is 58.5% of list, *i.e.,* on a $100 part dealer cost will be $60 off PAD and $57 on PAD, the average of these two is $58.50 or 58.5% of list. When 25% is used as the measure of the dealer's wholesaling cost, the average total cost of the part to the dealer is his average purchase price plus 25% of dealer net (58.5% × 25% = 14.6%. 14.6% + 58.5% = 73.2% of list price) which translates into about list less 27% as the net cost to the dealer for parts he uses in his own body shop. On warranty work, where the reimbursement is 30% of dealer net the net cost to the dealer is 76% of list price which translates into about list less 24%. (58.5% × .39% = 17.5%. 17.5% + 58.5% = 76.5% of list price). Without the PAD allowance, the cost to the dealer is from list less 25% to list less 22% (RPF 139).

262. IBSs do not incur the stocking costs of GM dealers in [52]

handling crash parts (Tr. 14016). IBSs testified that they do not provide for themselves wholesaling services or incur the costs related to them (Tr. 7662–63, 7973–40) (RPF 140).

263. GM dealers charge IBSs, 25% to 40% off suggested list price for compensable crash parts (Tr. 10847–48, 10664–65). (RPF 141).

IBSs Numbers, Sales Volume and Numbers of Employees

264. IBSs are generally smaller operations than GM dealer body shops, the former often being one or two man shops (CX 7327G; Tr. 4796–97, 4866, 8292) (CCPF 151).

Growth in Numbers - Government Data

265. For the period 1963 through 1967, U.S. Census Bureau Data show that the number of IBSs (SIC Code 7531) increased by 4,621 (28.5%) (RX 39). During this period, GM did not pay wholesale compensation on crash parts sales. Wholesale compensation began in September or October, 1968 (Tr. 2096–97) (RPF 152).

266. Between 1967 and 1972, the number of IBSs reporting to the U.S. Census Bureau grew by 10,982 (52.7%), while the estimated number of GM dealer body shops declined about 343 (3.6%) (RX 38; RX 39) (RPF 153).

267. According to U.S. Census Bureau data, the number of non-dealer repair shops, other than body shops (SIC Codes 7534, 7538 and 7539) increased by 24% between 1967 and 1972, a significantly lower growth than that of the IBSs. These non-dealer repair shops are categorized by the Census Bureau as "General Automotive Repair Shops", and "Other Automotive Repair Shops" (RX 39) (RPF 154).

268. IRS data showing the numbers of IBS proprietorships and partnerships (but not corporations) indicate a growth between 1967 and 1972 of 51% (RX 314A) and a growth between 1967 and 1976 of 55.3% (RX 318). Between 1967 and 1976, GM body shops declined in number by 4.2% (RX 38) (RPF 155).

Growth in Sales - Government Data

269. For the period 1963 through 1967, U.S. Census Bureau data show that sales by IBSs grew by $263 million (47%) (RX 39) (RPF 157).

270. Between 1967 and 1972, sales by IBSs, according to Census data, increased by nearly $952 million or 116%, while GM car dealer body shops' sales, according to GM data, increased by approximately $226 million or 40%. During the same period, according to Census

data, non-dealer repair shops, other than [53]body shops, had a sales increase of 62% (RX 38; RX 39) (RPF 158).

271. According to IRS data, between 1967 and 1976, sales by IBS partnerships and proprietorships grew by 151%. Unlike the Census data, the IRS data do not include corporations (Tr. 14326). Over the same period GM body shops' sales grew by 92% (RX 317) (RPF 159).

272. The growth in sales by IBSs, including corporations, can be estimated by the process of linking the Census data, showing the growth of sales of IBSs (corporations *included*) over the 1967–1972 period, with the IRS data showing the growth in sales of IBSs (corporations *excluded*) over the 1972–1976 period (Tr. 16027–34).

273. Between 1967 and 1972, IBS corporations grew by a higher precentage than IBS partnerships and proprietorships (Tr. 14370). Assuming that IBS corporations grew by only the same percentage as the IBS partnerships and proprietorships in the period 1972-1976, it is estimated by using the linking process, that IBSs (corporations included) grew in 1967-1976 by 196%, or by more than twice the percentage (92%) that GM dealer body shops grew over the same period (RX 322) (RPF 160).

Dun and Bradstreet Data

274. Dun and Bradstreet data demonstrate that IBSs have continued to grow in numbers, sales, and employees. From 1972 to 1977 the number of IBSs surveyed by Dun and Bradstreet grew by 53%, or from 11,644 to 17,864. The number of GM body shops (according to GM data) declined from 9057 to 9001. Sales receipts for these IBSs grew by 85% or from $894 million to $1.651 billion. GM dealer body shops' sales (according to GM data) increased by 53%, or from $571 million to $979 million. According to the Dun and Bradstreet survey, the number of non-dealer repair shops other than IBSs increased in the same period by 20%, a significantly lower growth rate than that of the IBSs. These non-dealer repair shops also experienced a lower growth in sales when compared to IBSs, 76% compared to 85% for the IBSs. The number of employees of IBSs also grew between 1972 and 1977 from 49,438 to 80,019 (62%), compared to employment growth in non-dealer repair shops, other than IBSs, from 235,179 to 244,622 (4%) (RX 38, RX 43) (RPF 162).

275. A Dun and Bradstreet study also reveals that the failure rate for IBSs was 15 per 10,000 in 1977, a decline from 32 per 10,000 in 1972. Only one of the 23 retail lines of business for which Dun and Bradstreet maintains failure rates in the normal course of business experienced a lower failure rate in 1977. Motor vehicle franchise

dealers had a failure rate of 20 per 10,000 (RX 303A–B; Tr. 12251) (RPF 164). [54]

Telephone Directory Listings

276. Based on telephone directory (Yellow Page) listings, the number of IBSs in Buffalo, Cleveland, New Orleans, St. Louis and Tucson has grown over a ten-year period. Between 1967 and 1977, the growth rate was almost 83%. In St. Louis, the growth rate was in excess of 26%. In Tucson, the rate was about 105%. During the ten-year period, the body shop growth rate for these five areas was 38%. For Spokane, there are no comparable data for 1967, but in the five-year period between 1972 and 1977, there was an increase of over 30% in the number of IBSs (RX 41) (RPF 166).

277. Based on 1977 Yellow Pages listings, more than 72% of the IBSs in Commission counsel's selected areas, excluding Mansfield, Ohio, are located where population has been declining. From 1970 through 1975, Buffalo lost 1.6% of its population; Cleveland, 4.3%; and St. Louis, 1.7%. During the same period, the nation's population rose by 4.8%. The two remaining cities, which showed an increase in population since 1967, and for which ten-year body shop data are available, are New Orleans and Tucson. These cities show an increase in the total number of IBSs of approximately 83% and 105%, respectively, which outstripped the percentage increase in the populations of these areas between 1970 and 1975 (RX 41; RX 42) (RPF 168).

278. Several witnesses testified that listings in the Yellow Pages are a reliable method of analyzing numbers of IBSs entering or leaving the business (Tr. 4269, 7047) (RPF 167).

Financial Health

279. Some of the IBSs that grew the most in terms of gross sales declined in profitability, or actually experienced losses (Tr. 4184–85; 4816–20). Others that grew in terms of gross sales in fact cut back on their number of body repair men, billed fewer hours or repaired fewer vehicles (Tr. 4205, 4207, 4227, 6557–58, 6590–91, 6650-52).

280. Not only is the apparent profitability of IBSs very low, but the actual return to the owners is even lower than the profit figures indicate due to the owners' low salaries or withdrawals (Tr. 2292–93, 2483–84, 4010–11, 4827, 4831, 4841–42, 4859).

281. In recent years, as the profitability of collision work has declined, many IBSs have entered into other fields, most of which are related to collision repair work (Tr. 15250–51), such as towing (Tr.

5692); boat repair (Tr. 6775–76); appraisals (Tr. 4794–95, 4967); salvage pools (Tr. 7039); fiberglass repairs (Tr. 3125); gasoline sales (Tr. 5691–92); office furniture and cabinet repair (Tr. 7041, 9373); design and [55]installation of van interiors (Tr. 7042); salvage vehicle rebuilding (Tr. 5987, 9374); patchwork on rusted out cars (Tr. 4945); mechanical and radiator repair (Tr. 3777); body shop supplies, abrasives and heavy equipment wholesaling (Tr. 6163–64); rust proofing (Tr. 3994); and frame straightening (Tr. 4823–24, 4967, 7095).

282. In practically all cases, these sideline operations have assumed an increasing share of the IBSs' total volume of business because they are more profitable than collision repair work (Tr. 3681, 4121, 4190, 4967–68). In some cases, IBS operators have virtually closed down their automobile collision repair operations in favor of these other enterprises (Tr. 4041, 9374) (CPF 169).

283. Other IBSs concentrate on specialized collision repair work (Tr. 8287–91 (heavy duty trucks and equipment); Tr. 2982 (heavy trucks and buses); Tr. 5569 (heavy equipment); Tr. 7911 (Winnebago campers); Tr. 9374 (vinyl tops and customizing, trucks and trailers)) (CCPF 171).

284. Sublet work from dealers constitutes a significant share of the volume of some IBSs (Tr. 5009–10, 7906, 7911–13). IBSs generally are eager to take on any sublet work they can get (Tr. 4858–59; see official notice Tr. 15251–52) (CCPF 174).

285. If IBSs received price parity in obtaining service GM crash parts, IBS witnesses testified they would: (1) expand and modernize their facilities (Tr. 9376); (2) purchase new and more sophisticated equipment (Tr. 4864); (3) hire additional or more skilled employees (Tr. 3127, 3668); (4) raise their employees' salaries or provide fringe benefits such as paid vacations, uniforms, and hospitalization benefits (Tr. 2860, 7570); (5) complete their repair jobs more quickly (Tr. 9376, 3866, 4864); and (6) provide for consumers such incidental services as free undercoating and car washes (Tr. 3127) (CCPF 297).

286. Some IBS witnesses testified that their body shops were operating at or very near capacity (Tr. 6120, 3210, 2912 ("runs a full house," has plenty of business); 4048–49, 4121 (80% capacity, in November 1977, already booked through January 1978); 4882, 4945–46, 5102–03 (90% capacity currently, in 1977 was full); 8344–45, 2632, 2660 (no trouble getting business; could not take on 10–15% more work without improving facilities and adding men); 6259–60, 6319 (had all the work he could handle, had to reject jobs, which went to GM dealers)) (RPF 175).

287. A number of IBS witnesses testified that they added to their

capacity during the 1970's by construction of additional buildings and the addition of expensive equipment (Tr. 3100, 3189, 3208 (added 29 bays in 10 years, 15–20 bays added in 1973 with new building), 2291 (added buildings and equipment, 1973–76), 5096 (invested $40,000 in frame equipment), 5334–35 **[56]**($5,000 lift, $12,000 new doors), 3906–07, 3915–16 (equipment and real estate purchased in 1968, 1974 and 1976–77), 7905–06, 4188–89 (1970-new building and frame rack for $20,000)) (RPF 176).

Relationships Between GM, Its Dealers, and Crash Parts

288. Dr. Nelson testified that GM is dependent on its dealers' loyalty and good will to sell its major product—motor vehicles—and that GM dealers oppose losing their exclusive wholesaling privileges on new service GM crash parts, a major parts item with them on which they face limited competition (Tr. 14869, 14879). In confining the distribution of GM crash parts to its dealers, GM dealers are dependent on GM not only for the vehicles they sell, but also for the crash parts to repair such vehicles (Tr. 14833).

289. Various dealer advisory bodies regularly meet with GM officials. For the General Motors Dealers Council, GM dealers in each of numerous geographical zones vote within their division (*i.e.,* Chevrolet, Oldsmobile, Pontiac, Buick, Cadillac, and GMC Truck) to elect representatives to Regional Dealer Councils. The Regional Councils in each division elect a representative to the Divisional National Council. Each of these six National Councils elects a Chairman from among its membership. The Councils solicit and receive opinions from dealers regarding GM's policies and meet periodically with GM executives to communicate these views and to make recommendations (CX 7208, CX 7209A–B, CX 7210A–C, CX 7211A–B, CX 7212A–D, CX 7213A–B, CX 7214A–C, CX 7215A–B; Tr. 2070, 3311–17, 3320–21, 3428–31, 4604, 8137–38) (CCPF 278) (RRB 278).

290. GM also has other dealer advisory bodies such as its President's Committee and its National Advisory Counsel (Tr. 8139, 3437) (CCPF 279).

291. GM franchise dealers also are organized to present their views to GM through NADA (Tr. 3422). About 70% of all GM dealers belong to NADA (Tr. 8212). NADA has an Industry Relations Committee (IRC) which is composed of new car and truck franchise dealers broken down into "line groups" according to car make. At present, the IRC is comprised of various groups, one of which is the General Motors Line Group. IRC, particularly the GM Line Group, is the official voice of NADA's GM dealer members (CPF 268). The

chairman of the GM Line Group is a GM dealer who is appointed by the president of NADA in consultation with the Industry Relations Committee Chairman. In addition to the chairman, the GM Line Group includes each chairman of the six GM Divisional National Councils (Tr. 3316, 3422, 3431–33) (CCPF 280) (RRB 280).

292. Over the past few years, GM dealers, either individually, through their trade association NADA or through [57]GM's dealer councils, have had numerous discussions, communications, and meetings with GM concerning the Commission's investigation into GM's distribution of new GM crash parts, the system itself, and ideas to change the system (CX 7301A, Tr. 3462, 3483–84, 3500, 3517, 8062–63, 8068, 8170, 8177–78, see, *e.g.,* CX 7205A, C; CX 7303A–E; CX 7313M–O, CX 7314A–B; CX 7316A–B; CX 7317; CX 7318; CX 7332A–E; CX 7355B) (CCPF 281) (RRB 281).

293. During many of these discussions, communications, and meetings, GM dealers, directly or through their associations, have repeatedly urged GM not to sell service GM crash parts to other than GM dealers (CX 7301; CX 7314B; CX 7319; CX 7341A–B; CX 7352A–B; Tr. 3361, 4687–89; see Stipulation Tr. 3376) (CCPF 282).

294. For over a year prior to GM's July, 1975, proposal to the Commission, NADA representatives ". . . debated the crash parts issue with the Federal Trade Commission and General Motors" and ". . . repeatedly urged General Motors not to open their warehouses," *i.e.,* not to sell non-dealers (CX 7314B) (RPF 224).

295. In May, 1975, NADA officials, at a meeting attended by Mr. Estes, GM's president, and other GM officials, indicated their opposition to the opening of GM's warehouses to either IBSs or IWs (Tr. 4687–90; CX 7314) (RPF 225).

296. Mr. Estes, expressed sympathy with NADA's viewpoint, namely, ". . . that the present system served the consumer properly and that the dealers had made an investment," but also indicated that GM was under considerable pressure and that more was at stake than merely parts distribution (Tr. 4690) (RPF 226). On June 15, 1975, Mr. Pohanka, a GM dealer in the Washington, D.C. area, who at that time was vice-president of NADA urged GM, by telegram to Mr. Estes, not to open its warehouses (Tr. 4668; CX 7314B) (RPF 228).

297. A GM representative called the Executive Director of NADA to inform him that GM was about to extend the July 11, 1975, settlement proposal to the FTC (Tr. 3539) (CCPF 289).

298. Immediately after GM's offer was announced, NADA organized to fight it (Tr. 3564). NADA sent a circular to all NADA members which stated that the GM proposal was a serious threat to

dealers and that an increase in wholesale compensation was what was needed (CX 7314A–C). This was followed by a Mailgram to all NADA members urging them to write Mr. Estes, and ask him to withdraw GM's offer (CX 7349B). In response to this request, a large number of letters were sent to GM by its dealers urging withdrawal of the offer (Tr. 4721) (CCPF 290).

299. The July 11, 1975, settlement proposal, among other [58] things, would have led to the direct sale by GM of new GM crash parts at dealer net prices to IBSs (CX 7010; ALJX 11; Tr. 3559) (RPF 229). Mr. Hancock, NADA's president at the time, Mr. Pohanka, the vice-president, and Mr. McCarthy, the chief administrative officer (Tr. 3422), were informed of GM's proposal on the same day that it was made to the Commission (CX 7314B; Tr. 3559–60; CX 7321) (RPF 230).

300. NADA "strongly" opposed GM's offer to open the warehouses to IBSs and expressed its opposition to individual Federal Trade Commissioners and to members of the FTC staff (Tr. 3560–62). NADA also made public its opposition through a press release issued July 25, 1975 (CX 7301A–B; Tr. 3480) (RPF 232).

301. NADA's efforts to convince GM to abandon its proposal to sell directly to IBSs consisted of "argument". Mr. Pohanka testified, "We were very distressed when General Motors made the offer to the Federal Trade Commission that they did. We felt it was not in the best interests of the dealer or the consumer, and told General Motors about that" (Tr. 4717–18). GM informed NADA that it did not intend to withdraw its settlement proposal (CX 7305, Tr. 3563–64).

302. On December 17, 1975, representatives of GM and NADA met to discuss the latest developments regarding GM's crash parts distribution system. Mr. Mehan, speaking for GM, stated that getting independent distributors into crash parts would result in greater costs to consumers and cause greater dealer problems (CX 7316A; CX 7324A; Tr. 3524). NADA countered with its Four Point Program which did not include opening GM's warehouses to non-dealers (CX 7316B; Tr. 3525–29). The question, insofar as one attendee noted, and he was the only one so noting, was, "What can GM and dealers do together to keep 'independent distributors' out of crash parts area?" Another attendee disputes the accuracy of the note (Tr. 3519–22; CX 7324B) (CCPF 292) (RRB 292).

303. On February 5, 1976, GM and NADA sent separate settlement proposals to the FTC which were described by one NADA official as "essentially the same". The GM proposal was very similar to NADA's Four Point Program (CX 7353B; compare ALJX 13A–I, Supp. to CX 7012 with CX 7327A–G Point 1). Raising wholesale

compensation to 30% had already been adopted by GM prior to the February settlement offer (ALJX 13G, Supp. to CX 7012).

304. As advocated by NADA, GM's proposal did not include the July, 1975, offer to sell crash parts directly to IBSs but did call for wholesale compensation to be paid on crash part sales across franchise lines, *i.e.,* a Chevrolet dealer selling a Pontiac part would be eligible to claim wholesale compensation (ALJX 13G, Supp. to CX 7012) (CCPF 293). **[59]**

305. NADA did not ask GM's opinion of the NADA proposal (Tr. 3570–71, Tr. 4768–69) (RPF 243) and NADA had no advance knowledge of the February 5, GM proposal (Tr. 3570–72; Tr. 4768). (See Finding 52, 303–4).

DISCUSSION

The Relevant Markets

1. *The Product Market*

306. Identification of the relevant product market or submarket is the first step in a monopolization case. *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 324 (1962). Commission counsel contends that the relevant product market consists of service (new) GM crash parts (CPF 53–59). GM objects to isolation of crash parts for separate analysis from the rest of the "transportation package" it sells in competition with other manufacturers, on the ground that doing so ignores the often exercised owner option to repair parts which have been crash damaged. GM argues that if crash parts are to be so isolated then used crash parts must be included within the relevant market. (RB 5)

307. Counsel to GM also argues that in *United States* v. *Aluminum Co. of America* [Alcoa], 148 F.2d 416, 424–25 (2d Cir. 1945), Judge Learned Hand reasoned that the company took into account that part of its current production would be salvaged in determining what its output of new aluminum should be. GM, the argument goes, is merely interested in increasing the sale of new cars and the expected supply of used crash parts is not a factor taken into account in the production of new cars (RB 9). But Judge Hand's reasoning that the secondary material market for aluminum curbs prices of new aluminum does not mean that in this case both new and used crash parts must be combined in defining the relevant product market. Even if GM does not take the supply of used crash parts into account in determining what its output of new cars will be, that fact does not obviate existence of a separate and distinct new GM crash

parts market. The precedents reflect that making that determination is accomplished by examining the product involved and not necessarily by considering how the producers view them.

308. "Cross-elasticity of demand" was the criterion used to identify the relevant product market in *United States* v. *E.I. du Pont de Nemours & Co.,* the "cellophane" monopolization case. 351 U.S. 377 (1955). It was stated that ". . . commodities reasonably interchangeable by consumers for the same purposes make up that 'part of the trade or commerce', monopolization of which may be illegal." 351 U.S. at 395. In other words, under the cross-elasticity of demand test, if purchasers can substitute the products of one supplier for the [60]products of other suppliers, the products which may be substituted are included in the market for examination. But that standard proved too restrictive to always be used.

309. Seven years later, in *Brown Shoe, supra,* after citing *Dupont/Cellophane,* the Supreme Court said that while there may be broad product markets whose outer boundaries ". . . are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it . . .," there also may be "well defined submarkets" within the broader market. 370 U.S. at 325.

310. The Court added that relevant submarkets could be identified by ". . . such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes and specialized vendors." 370 U.S. at 325. The result was that in *Brown Shoe,* the markets for men's, women's, and children's shoes were examined because they were economically significant submarkets within the shoe industry.

311. A few years later in *General Foods Corp.* v. *F.T.C.,* 386 F.2d 936, 940 (3rd Cir. 1967), *cert. denied,* 391 U.S. 919 (1968) (which was cited by the Commission in *Borden, Inc. (ReaLemon)* 92 F.T.C. 669, 784, n.8 (1978) and is the Commission's most recent opinion in a monopolization/monopoly power case) the court again made it clear that the existence of some cross-elasiticity of demand or as the Commission put it in *Borden/ReaLemon,* some degree of interchangeability, does not foreclose the existence of submarkets identified by *Brown Shoe* criteria.

312. There is a detailed discussion of the reasons for the development of the seven criteria test in *Reynolds Metals Co.* v. *F.T.C.,* 309 F.2d 223, 226–229 (D.C. Cir. 1962), a merger case involving acquisition of a producer and seller having a substantial

(33%) market share of the decorative aluminum foil market by a major manufacturer of aluminum. Also see *L.G. Balfour Co.* v. *F.T.C.,* 442 F.2d 1, 11 (7th Cir. 1971) and *RSR Corp.* v. *F.T.C.,* 1979–1 Trade Cases, ¶ 62,450, p. 76,663–64 [13 C.D.1].

313. In *United States* v. *Aluminum Co. of America* (Alcoa-Rome), 377 U.S. 271 (1964), separate aluminum and copper submarkets were found to exist in the wire and cable industry. Existence of a separate paper insulated power cable submarket within a stipulated insulated wire and cable line of commerce (market) was found in *United States* v. *Kennecott Copper Corp.* (Kennecott), 231 F.Supp. 95, 98–100 (S.D.N.Y. 1964) *aff'd per curiam.* 381 U.S. 414 (1965). In *United States* v. *Bethlehem Steel Corp.,* 168 F. Supp. 576, 593–95 (S.D.N.Y. 1958), the iron and steel industry was found to be the relevant broad **[61]**line of commerce, but ten specific products (*e.g.,* hot rolled sheet, track spikes, electricweld pipe, oil field equipment supplies) were held to be identifiable submarkets as well.

314. In *United States* v. *Grinnell Corp.,* 384 U.S. 563, 572–573 (1966) (a leading monopolization/monopoly power case), the Supreme Court said, ". . . in § 2 cases under the Sherman Act, as in § 7 cases under the Clayton Act [citing *Brown Shoe*] there may be submarkets that are separate economic entities. *** We see no reason to differentiate between 'line' of commerce in the context of the Clayton Act and 'part' of commerce for purposes of the Sherman Act, [citing *United States* v. *First National Bank & Trust Co.,* 376 U.S. 665, 667–68 (1964), a § 1, Sherman Act case]." Also see *Columbia Broadcasting System* v. *F.T.C.,* 414 F.2d 974, 978–79 (7th Cir. 1969), *cert. denied,* 397 U.S. 907 (1970).

315. The consistent thread running through the decisions is that the objective and need is to delineate markets which conform to areas of effective competition and to the realities of competitive practice, regardless of which test is used. *Balfour, supra,* 442 F.2d at 11. The approaches to identify broad markets and the submarkets contained with them, are described in *Borden Inc./ReaLemon, supra,* 92 F.T.C. at 783–84.

316. By reference to *Brown Shoe* indicia and the cross-elasticity of demand test in *Dupont/Cellophane* it is possible to combine crash parts, both new and used, together with the repair of crash damaged portions of a vehicle in a three component, broad relevant market, as counsel to GM suggests. Examining *only* such a market would be appropriate in a case in which the focus is *solely* on the alternative ways in which a crash damaged vehicle might be repaired but that is not our focus here. Our role is to determine whether there is a substantial anticompetitive effect on any product market affected by

the acts or practices alleged to be illegal, *i.e.,* the distribution by GM of new crash parts.

317. Commission counsel relies on five of the *Brown Shoe* criteria to separate new and used crash parts into two submarkets: (1) specialized vendors; (2) peculiar characteristics and uses; (3) industry and public recognition; (4) distinct prices; and (5) sensitivity to price changes (CCPF 379–396).

(1) *Specialized Vendors*

318. With the exception of a very small number of crash parts, GM is the sole distributor of new GM crash parts and distributes them to its franchised dealers. GM does not sell used GM crash parts (Findings 12(8)(9), 68). These are obtained only from specialized outlets, *e.g.,* salvage yards and bumper rechromers (Finding 214). **[62]**

(2) *Peculiar Characteristics and Uses*

319. The limited availability of used (salvage) crash parts for vehicles less than two years old (Finding 235) and the fact that certain service parts, *e.g.,* exterior moldings, grilles, fenders, bumpers, quarter panels, etc., are seldom available in salvage form (Finding 222) distinguish new from salvage GM crash parts. In addition, dealers sell new crash parts as individual items, whereas salvage yards most frequently sell their product as part of large assemblies (Finding 223) requiring different types of labor for installation.

320. As pointed out by Commission counsel (CCPF 387), distinctions in quality have been held to justify treating two products as being in separate markets. *United States* v. *Pennzoil,* 252 F. Supp. 962, 972–76 (W.D. Pa. 1965). *A.G. Spaulding & Bros., Inc.* v. *F.T.C.,* 301 F.2d 585, 599–603 (3rd Cir. 1962). The fact that used crash parts are often bent, rusted, irregular, and more difficult to repair (Finding 225) is a peculiar characteristic which justifies new and used crash parts being considered as separate submarkets.

(3) *Industry and Public Recognition*

321. Individuals in salvage crash parts and bumper rechroming businesses recognize that these industries are separate from the distribution of new crash parts (Finding 225). Separate trade associations exist (Findings 14 and 15) which is further evidence that the two industries are distinct. *Bethlehem Steel, supra,* 168 F. Supp. at 594; *United States* v. *Citizen Publishing Co.,* 280 F. Supp. 978, 985 (D. Ariz. 1968), *aff'd,* 394 U.S. 131 (1969). In addition, vehicle owners

and body shops prefer the use of new crash parts (Finding 224), recognizing that quality distinctions may exist, despite possible insurance company preferences for the use of salvage parts (Findings 218, 230, 240).

(4) *Distinct Prices*

322. There is generally at least a 25% price differential between wholesale salvage crash parts and their new counterparts (CCPF 96). Similar price differences have been considered "strong evidence" of separate markets. *Borden/ReaLemon, supra,* 92 F.T.C. at 763, citing *Brown Shoe; Alcoa-Rome, supra,* 377 U.S. at 276; *Reynolds Metals, supra,* 309 F.2d at 229; *Litton Industries, Inc.,* 82 F.T.C. 793, 997 (1973).

(5) *Price Sensitivity*

323. There is a lack of mutual price sensitivity between new and used GM crash parts (CPF 41, 94, 94A, 95). GM uses a list price for parts. It is distributed nationwide and does not **[63]**take into account variations in prices for salvage crash parts, marketed on a local level, for which the prices change frequently (CPF 95).

324. Counsel to GM contends that use of *Brown Shoe* standards will result in an even broader definition of the product market than Commission counsel advocates in that it would include used GM crash parts (RB 8). The reasoning of counsel to GM is not persuasive. It is true that insurance companies, salvage operators, and installers understand that new and used crash parts are both options to be considered in the repair of crash damaged cars (RPF 191–202), but there is still recognition that there are two separate and distinct systems of distribution.

325. Salvage part prices and the cost to repair rather than replace are taken into account by insurers in arriving at the figure they will pay to have a vehicle fixed. The prices for salvage parts or for repairs, if there is any connection, normally "follow" rather than "lead" the prices GM establishes for new crash parts but model year of the car also affects the "used" price (Findings 227–8, 236). The lack of mutual price sensitivity (*i.e.,* one product is price sensitive to another but not vice versa) has been held to be evidence of separate markets. In *Dean Foods Co.,* 70 F.T.C. 1146 (1966), the Commission found that the price of retail milk moved as the price of wholesale milk moved. However, wholesale milk prices were not sensitive to retail milk prices. In finding separate markets the Commission stated:

What is of significant determinative value in determining the proper scope of a

market involving the same product is whether the price sensitivity which does exist is mutual, whether it is generated equally by both sectors or whether, on the other hand, the competitive forces are all generated primarily in one sector.

70 F.T.C. at 1258 (CCPF 395). This lack of mutuality is also evidenced by the fact that salvage crash parts are 75% to 90% of list in the first three model years and decline to 25% to 50% of list thereafter (Tr. 1747–48).

326. Although both types of crash parts are used to repair damaged cars, this does not negate the fact that two separate markets might be found for monopolization purposes. For example, the Commission adopted the following language in *Borden/ReaLemon, supra,* 92 F.T.C. at 762, 832.

. . . [R]ecognizing that fresh lemons and processed lemon juice are used for many of the same purposes by the public, does not dictate that they must be placed in the same product market where serious, important and [64]economically substantial distinguishing characteristics differentiate the products . . .

In that case, fresh lemons and processed/bottled lemon juice were found to be in different product markets because the bottled product had limited use due to its distinctive taste and the additives it contained, whereas fresh lemons were less convenient to use, subject to spoilage, and had a higher cost. This conclusion was reached without resort to the *Brown Shoe* criteria. 92 F.T.C. at 788. The differences between new and used crash parts are equally significant.

327. Counsel to GM suggests that "reasonable interchangeability"/"cross-elasticity" should be the test used to identify the product market here. I do not agree. Two products may have reasonable interchangeability of use or cross-elasticity of demand, but well-defined submarkets still may exist within a broad market, and they may be product markets for antitrust purposes. *Borden/ReaLemon, supra,* 92 F.T.C. at 762, 832.

328. It has often been held that new products may be separated from their used or recycled counterparts in determining the relevant product market. *Alcoa,* discussed at p. 59. Also see *Avnet, Inc.* v. *F.T.C.,* 511 F.2d 70 (7th Cir. 1975); *United States* v. *Paramount Pictures,* 334 U.S. 131 (1948); *RSR Corp., supra.*

329. Lastly, the fact that not all of the *Brown Shoe* criteria have been used in defining the relevant market is not significant. There are a number of precedents *(e.g., Alcoa-Rome, Kennecott)* for the proposition that not all, or even most, of them need be taken into account. *United States* v. *Continental Can Co.,* 378 U.S. 441, 456–57 (1964); *General Foods Corp., supra,* 386 F.2d at 941; *Columbia*

Broadcasting System, supra, 414 F.2d at 979. The new GM crash parts market is "sufficiently inclusive to be meaningful in terms of trade realities." *Crown Zellerbach Corporation* v. *F.T.C.,* 296 F.2d 800, 811 (9th Cir. 1961), *cert. denied,* 370 U.S. 937 (1962). Consequently, in this case, new GM crash parts comprise the relevant product market.

2. The Geographic Market

330. The geographic market which one must examine in order to determine whether the monopolization alleged is illegal may be identified in much the same way as the product market. In *Brown Shoe* the Supreme Court said that the ". . . criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market *** The geographical market selected must *** both correspond to the commercial realities of the industry and be economically significant *** [footnote omitted]. [A]lthough **[65]**the geographic market in some instances may encompass the entire Nation, in some other circumstances, it may be as small as a single metropolitan area." 370 U.S. at 336–37.

331. What is very clear from the precedents is that the geographic market to be examined need not be marked off in metes and bounds. *United States* v. *Pabst Brewing Co.,* 384 U.S. 546, 549 (1966); *du Pont/Cellophane,* 351 U.S. at 395.

332. The geographical effects of alleged violations of the antitrust laws have been considered by the Supreme Court and lower courts with reference to both broad geographic markets and submarkets within the broad area, in basically the same manner as in the case of product markets. *United States* v. *Kimberly-Clark Corp.,* 264 F.Supp. 439, 455–56 (N.D.Cal. 1967); *Bethlehem Steel Corp., supra,* 168 F.Supp. at 601–02.

333. In *Grinnell, supra,* 384 U.S. at 576, the court said ". . . the relevant market for determining whether the defendants have monopoly power is not the several local areas which the individual stations serve, but the broader national market that reflects the reality of the way in which they built and conduct their business."

334. Even if GM did not actually sell its crash parts in every state, which is contrary to the evidence in this case, there are numerous precedents to the effect that a national market may exist. See *F.T.C.* v. *Procter and Gamble Co.,* 386 U.S. 568, 571–72 (1967); *Pabst, supra,* 384 U.S. at 549–551; *A. G. Spaulding, supra,* 301 F.2d at

607; *Kimberly-Clark, supra,* 264 F. Supp. at 454–458; *British Oxygen Company Limited, et al.,* 86 F.T.C. 1240, 1346–47 (1975).

335. The nation as a whole most assuredly is significant economically and is the area where the effect of the monopoly/monopoly power on competition is direct and immediate. The Supreme Court has held this to be an appropriate "section of the county"/"geographic market" insofar as antitrust violations are concerned. *Philadelphia National Bank,* 374 U.S. 321, 357–362 (1963). The Commission did the same in *Borden/ReaLemon, supra,* 92 F.T.C. at 675, 832.

336. In this case the United States as a whole is the relevant geographic market. This is because new GM crash parts are marketed nationally (Finding 67). This fact alone warrants considering the nation as the relevant geographic market. See Commission Opinion in *Beatrice Foods Co.,* 86 F.T.C. 1, 60 (1975).

Antitrust Case Decisions as Precedents for Section 5 FTCA Decisions

337. With regard to the fact that many of the cases cited as precedents have involved charges of several different **[66]**violations of the antitrust laws or the Federal Trade Commission Act, the standard for outlining the relevant markets is no different whether a case has been brought under the Sherman, Clayton *or* Federal Trade Commission Acts. *Borden/ReaLemon, supra,* 92 F.T.C. 784, citing *Luria Bros. & Co.,* 62 F.T.C. 243, 604 (1963), *aff'd,* 389 F.2d 847 (3rd Cir.), *cert. denied,* 393 U.S. 829 (1968); *Columbia Broadcasting, supra,* 414 F.2d at 978–79.

Monopolization/Monopoly Power

338. Monopoly power is the power to control prices or to exclude competition. *American Tobacco Co.* v. *United States,* 328 U.S. 781, 811 (1946). It usually can be inferred from possession of a predominant share of the relevant market. *Grinnell, supra,* 384 U.S. at 571; *Dupont/Cellophane, supra,* 351 U.S. at 391. Having identified the relevant product and geopraphic markets, the respondent's share of those markets is considered to determine whether the firm's actions constitute monopolization or whether the firm has monopoly power. *Grinnell, supra,* 384 U.S. at 571.

339. "Size is of course an earmark of monopoly power" *United States* v. *Griffith,* 334 U.S. 100, 107 n.10 (1948). GM's size (Finding 65) and the fact that its crash parts are made for GM cars only

(Finding 114) make it clear that GM *has* monopoly power, insofar as new GM crash parts are concerned.

340. The market share of the relevant product(s) in the relevant geographic market, that is the annual sales figure, is used in making this determination. It has been held that the share probably must be greater than sixty percent in order for monopoly power to exist. *Alcoa, supra,* 148 F.2d at 416. Alcoa had 90% of the relevant market in virgin aluminum. 148 F.2d at 424. Here, GM approaches a 100% share because it supplies practically all of the new GM crash parts which are distributed (Finding 68).

341. GM is able to (and does) set the prices of the crash parts it sells without any real concern for the near term reactions which dealers or others might have to the increase in price. No doubt GM has concerns about possible long term effects price changes may have on car buyers' decisions. There was testimony that competitors' prices for crash parts are noted when price increases are recommended to higher level GM employees who make the decisions on prices (Finding 199). But there was no persuasive evidence to the effect that the adverse reactions of dealers, other repairers of damaged autos, or consumers are either considered or have a controlling influence on whether an increase should occur when price increases are being decided upon.

342. Thus, GM has a monopoly and monopoly power by virtue of the fact that, except for a very few parts, it is the [67]exclusive source of supply for new GM crash parts. This provides GM with a dominant market share and a position well insulated, even isolated, from competition for sales of new GM crash parts.

Were/Are GM's Practices an Abuse of Monopoly Power or Illegally Monopolistic?

343. A finding of a monopoly in the relevant market is not enough to constitute a violation of antitrust law, *i.e.,* of the Sherman Act (15 U.S.C. 2) because having a monopoly or monopoly power as such is not illegal *per se.* It is monopolization, attempts to monopolize, and abuses of monopoly power which are prohibited. "According to the court interpretations of this [Sherman Act] statutory language that have been handed down since 1890, Congress' failure to outlaw monopoly *as an end result* and focus instead on the *means* by which a monopolist was thought to get there was no accident or oversight: It didn't *want* to make monopoly illegal; it simply wanted to make sure that, wherever monopoly *does* appear, it will have been acquired fairly. [Emhasis added]". Mueller, "Entrepreneurial Education", 2

Antitrust L. and Econ. Rev. 4 (1979). "To monopolize is not simply to possess a monopoly: the word implies some positive drive, apart from sheer competitive skills, its size and power in the market." Neale, *The Antitrust Laws of the USA* (2nd Edition, 1970) 92, 93.

344. "The Sherman Act was intended to secure equality of opportunity and to protect the public against evils commonly evident to monopolies and those abnormal contracts and combinations which tend directly to suppress the conflict for advantage called competition—the plan of the contending forces ordinarily engendered by an honest desire for gain. The statute did not forbid or restrain the power to make normal and useful contracts to further trade by resorting to all normal methods, whether by agreement, or otherwise, to accomplish such purpose." *United States* v. *American Linseed Oil Co.,* 262 U.S. 371, 388 (1923) (citations omitted).

345. The acts and practices charged need not in themselves be independently unlawful or predatory to constitute violations of Section 2, but merely being a large company with a monopoly share of the relevant product market is not sufficient. *United States* v. *Griffith,* 334 U.S. 100, 105 (1948); *Alcoa, supra,* 148 F.2d at 431–32. However, as the Commission said in *Borden/ReaLemon, supra,* "One point made clear by the Alcoa case is that the *conduct* of firms with monopoly power is viewed differently from that of firms without such power [Emphasis added]." 92 F.T.C. at 794.

346. "The existence of monopoly power—'monopoly in the concrete' *Standard Oil Co. of New Jersey* v. *United States* [221 U.S. 62 (1911)] does not by itself prove the offense of [68]monopolization. . . . the offense is the existence of the power to raise prices or exclude competition, 'coupled with the purpose or intent to exercise that power.' The requisite intent for this purpose is not a 'specific' intent to monopolize, but rather a conclusion based on how the monopoly power was acquired, maintained or used." *Report Of The Attorney General's National Committee to Study the Antitrust Laws,* March 31, 1955, p. 55, citing *Griffith, supra,* 334 U.S. at 107; *American Tobacco, supra,* 328 U.S. at 809.

347. Consequently, for a violation of the antitrust laws to be found when a firm has a monopolist's share of the relevant markets, or when the firm has monopoly power, the firm must be shown to have conducted its business in such a way that it went beyond the very fine line dividing acceptance of its position and taking actions which would unduly stifle, frustrate or foreclose competition. For example, Alcoa, by expanding existing plants and constructing new facilities with the goals of building ahead of demand and unduly taking the initiative in dealings with purchasers, suppliers, and

competitors so as to preempt any diminution of its power was found to be an illegal monopolist under the Sherman Act. *Alcoa, supra,* 148 F.2d at 431–32. Also see *United Shoe Machinery,* 110 F. Supp. 295, 341 (D. Mass 1953); *Grinnell, supra,* 384 U.S. at 576.

348. Insofar as the Federal Trade Commission Act is concerned, neither an offensive practice nor conduct constituting a violation of the Sherman or Clayton Acts need exist for a violation to be found. The reason is that the Commission is not bound to follow antitrust standards as strictly as the courts must in cases brought under the Sherman and Clayton Acts. *Fashion Originators' Guild of America, Inc.* v. *F.T.C.,* 312 U.S. 457, 466–67 (1941); *Sperry & Hutchinson Co.* v. *F.T.C.,* 432 F.2d 146, 150 (5th Cir. 1970) *rev'd on other grounds,* 405 U.S. 233 (1972).

349. Controlling Commission *and* court precedents tell us that monopolization is illegal: *if* (1) the possessor has monopoly power in the relevant market and (2) that power was acquired or is maintained wilfully "as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Borden/ReaLemon, supra,* 92 F.T.C. at 788, citing *Grinnell, supra,* 384 U.S. at 570–71.

350. In addition to demonstrating that monopoly power exists, it must be shown that the power was *wilfully* acquired or maintained. Thus, in *Borden/ReaLemon,* the wilful nature of Borden's actions was shown by evidence that the firm took steps to *ensure* that its ". . . monopoly position would not be lost or eroded, and engaged in acts and practices designed to frustrate competition." 92 F.T.C. at 792. These steps included: (1) spurious product differentiation that enabled it to command a substantial price premium (p. 793); (2) manipulation of this **[69]**price differential (p. 793); (3) sacrificing somewhat higher prices over the short-run to assure continued monopoly returns over the long haul (p. 795); (4) the use of geographically discriminatory promotional allowances (p. 795–96); (5) demanding a price considerably in excess of that of competing brands in some areas and reducing prices selectively in areas where it wished to suppress emerging competition (p. 797); and (6) selling to competing customers in the same local market at different prices, without cost justification (p. 798–99).

351. To the same result see *Grinnell,* where the Court noted that the company: (1) used restrictive agreements to preempt its competitors; (2) used pricing practices to contain its competitors; and (3) acquired competitors in achieving its monopoly position unlawfully. 384 U.S. at 576.

352. No practices similar to those in which Borden and Grinnell

engaged have been shown to have been used by GM in order to acquire or maintain its monopoly in new GM crash parts. GM does require suppliers using its dies and inserts to sell their output only to GM (Finding 68), but the evidence does not show that GM takes action to inhibit the production of dies and inserts by others who might wish to make and sell crash parts or that GM seeks to enforce any design patents or common law rights it possesses in that regard. For example, a witness testified that his firm makes new crash parts for GM's Corvette without interference (Tr. 1895).

353. Contrary to the position of Commission counsel the facts here are very different from those found in *United States* v. *General Motors Corporation,* 121 F.2d 376 (7th Cir. 1941) and in *United States* v. *General Motors Corp.,* 384 U.S. 127 (1966). Counsel to ASC makes the same argument about the latter case (IAB, pp. 12–13). In the earlier case GM sought to extend its monopoly into another field (*i.e.,* the wholesale and retail financing of GM autos) by conspiring with General Motors Sales Corporation, General Motors Acceptance Corporation, and General Motors Acceptance Corporation of Indiana, Inc. and by coercing dealers to deal with the finance companies. 121 F.2d at 399. In the latter case GM combined with some of its dealers to stop other dealers from selling cars to discount houses, and policed their activities to insure that they did so. Justice Fortas found ". . . a classic conspiracy in restraint of trade: joint collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose." 384 U.S. at 140. No such evidence was disclosed in this case.

354. GM does have an inevitable monopoly in new GM crash parts. As to these ". . . some are natural, and others are 'thrust upon' their owners." But, as the Commission cautioned **[70]**in *Borden/ReaLemon:*

> . . . where a firm with monopoly power interferes with natural economic forces which would otherwise dissipate its monopoly, the law rightfully condemns it.

92 F.T.C. at 795.

355. The evidence here does not show that GM has interfered with natural economic forces which would otherwise dissipate its monopoly. Thus, insofar as the charges of monopolization/monopoly power over new GM crash parts are concerned GM ". . . falls within the exception established in favor of those [monopolists] who do not

seek but cannot avoid, the control of a market." Judge Learned Hand in *Alcoa, supra,* 148 F.2d at 431.

356. The teaching of *Alcoa* is that monopolization may be illegal not because a firm is progressive, but rather because it acted with calculation to head off every attempted entry into the field. The case is *not* to be interpreted as penalizing enterprise, instead it declares illegal those monopolies which are maintained by policies intended to discourage, impede or even prevent the rise of new competitors. *Attorney General's Committee Report, supra,* at 60. The evidence here does not show that GM has discouraged, impeded or prevented the rise of new competitors in the new GM crash parts market. The concurring opinion of Commissioner Pitofsky in *Borden/ReaLemon, supra,* details the law with regard to the maintenance of monopoly power by use of unreasonably exclusionary behavior. 92 F.T.C. at 820–821.

357. I am convinced that GM's restricting suppliers using its dies to sales to GM (Finding 68) is not unreasonable. There is no other showing in this case which persuasively evidences behavior by GM to exclude other manufacturers from the relevant market.

GM's Right to Choose Its System for Distributing New Service Crash Parts

358. Commission counsel contends that by selling new crash parts only to its franchised dealers, GM is using its monopoly power in violation of the Sherman Act, (or in violation of its spirit, and therefore illegally under Section 5 FTCA) because GM forestalls competition by its refusal to deal with other than its franchisees (CCPF 419). The following language from *United States* v. *Arnold Schwinn & Co.* is quoted to support his proposition that a manufacturer must deal with all those who seek to have it do so, when products competitive to the manufacturer's are unavailable.

> . . . [A] manufacturer of a product other and equivalent brands of which are readily available in the [71]market may select his customers, and for this purpose he may "franchise" certain dealers to whom alone, he will sell his goods. [Citations omitted]. If the restraint stops at that point—if nothing more is involved than vertical "confinement" of the manufacturers' own sales of the merchandise to selected dealers, and if competitive products are readily available to others, the restriction, on these facts alone would not violate the Sherman Act.

388 U.S. 365, 376 (1966).

359. Taken by itself, this language appears to confer an obligation to deal upon a manufacturer, but when examined in context it is clear that what the Supreme Court was talking about was part of the

broad outline of conduct permissible under the Sherman Act. The statement was meant merely to identify one end of a spectrum, with price fixing, conduct which never is permissible, identifying the other end.

360. I do not agree that *Schwinn, supra,* holds that a manufacturer of a product, having a monopoly in the relevant product market, must do business with all willing customers. In *Schwinn,* the Supreme Court merely held that the manufacturer imposed vertical restrictions on the resale of its goods by franchisees which constituted illegal restraints of trade. Schwinn's conduct was not a mere refusal to trade with those who were not franchisees. It imposed territorial limitations on resales by distributors and confined resales by franchisees and distributors of bicycles to franchised retailers. 365 U.S. at 370–71. No such limitations have been shown in this case. In fact, GM has encouraged dealers to sell to IBSs by having the wholesale compensation plan apply to such sales.

361. I agree with counsel to GM when he points out that, "Any analysis of the GM system must begin with the recognition that a manufacturer, absent any purpose to monopolize may choose the customers with whom it will deal." (R. Br. 18). *United States* v. *Colgate,* 250 U.S. 300, 307 (1919). *Oreck Corp.* v. *Whirlpool Corp.,* 579 F.2d 126 (2nd Cir.), *cert. denied,* 58 L.Ed. 2d 338 (1978); *Schwing Motor Co.* v. *Hudson Sales Corp.,* 138 F. Supp. 899 (D. Md.) *aff'd, per curiam* 239 F.2d 176 (4th Cir. 1956), *cert. denied,* 355 U.S. 823 (1957); *Quality Mercury, Inc.* v. *Ford Motor, Co.,* 542 F.2d 466 (8th Cir. 1976), *cert. denied,* 433 U.S. 914 (1977).

362. Further analysis of the system GM uses for distributing new GM crash parts starts from the premise that, absent a purpose to monopolize or an effect producing an unreasonable restraint on trade, GM may choose its system of distribution. In other words, it is still the law that a supplier may choose the customers with whom it will do business. **[72]**

363. The rationale for the principle as it applies to this case is set forth in *Schwing,* 138 F. Supp. at 902.

Every manufacturer has a natural and complete monopoly of his particular product, especially when sold under his own private brand or trade name. *Arthur* v. *Kraft-Phenix Cheese Corp.,* 26 F.Supp, 824, 828 (D.C. Md. [1937]). If he is engaged in a private business, he is free to exploit his monopoly by selling his product directly to the ultimate consumer or through one or more distributors or dealers, as he may deem most profitable to him. If he chooses the latter method, he may exercise his own independent discretion as to the parties with whom he will deal. This is a common law right which the antitrust laws have not destroyed. [citing *Colgate, supra; F.T.C.* v. *Raymond Bros.-Clark Co.,* 263 U.S. 565 (1924); *Times-Picayune, supra, Great Atlantic & Pacific Tea Co.* v. *Cream of Wheat Co.,* 227 F. 46, 49 (2d Cir. [1915])]. A refusal to deal

becomes illegal only when it produces an unreasonable restraint of trade or a monopoly forbidden by the antitrust laws. *Kiefer-Stewart Co.* v. *Joseph E. Seagram & Sons, Inc.,* 340 U.S. 211 [1951]; *Lorain Journal Co.* v. *United States,* 342 U.S. 143 [1951].

364. Thus, in the absence of any purpose to create or maintain a monopoly, or effect constituting an unreasonable restraint, it is legal for a manufacturer, engaged in an entirely private business, to exercise his own independent choice of the parties with whom he will deal. *Colgate, supra,* 250 U.S. at 307. But this right to choose the customers is neither absolute nor exempt from oversight by the government. And, if the right is exercised with the purpose or effect of monopolizing interstate commerce, or otherwise is unreasonable, such exercise is unlawful. *Lorain Journal Co., supra,* 342 U.S. at 155.

365. An individual refusal to deal, or, as here, GM's refusal to sell crash parts to anyone other than a GM dealer, is a circumscribable general right. If the refusal were accompanied by predatory conduct or agreement with other manufacturers, or if the general right were exercised to impede competition on the basis of price or for a monopolistic purpose, *e.g.* for market control, the refusal would be illegal. *Times-Picayune, supra,* 345 U.S at 622–23. For example, if GM refused to sell directly to IBSs or IWs in order to influence prices or to maintain or to extend power over the market that would be illegal. *Banana Distributors, Inc.* v. *United Fruit Co.,* 162 F. Supp. 32, 37 (D.C.N.Y. 1958). However, there is no evidence of any such conduct or effect in this record.

366. In the same year that *Alcoa* was decided, a District Court held in an often cited case that a monopolist had violated **[73]**the law in that its acts were *not* directed to any legitimate business venture oriented toward furthering its own business, but were, in fact, a calculated attempt to monopolize government contracts for a certain product. A refusal to deal, while it may be lawful *per se,* cannot be used in order to achieve an illegal result. *United States* v. *Klearfax Linen Looms,* 63 F.Supp. 32, 39 (D.C. Minn. 1945). Also see, *Eastman Kodak Co.* v. *Southern Photo Materials Co.,* 273 U.S. 359, 375 (1927), where Kodak illegally sought to move into retailing through use of its monopoly in film by refusing to continue to sell photographic supplies to a retailer at dealers' discounts.

367. The question to be answered, in the absence of predatory motives and with the presence of legitimate business purposes (such as a better way to distribute new GM crash parts in order to promote the sale of new cars, or to stabilize dealer outlets or to augment profits—GM's motives here), simply is whether the effect of GM's refusal to deal with other than its dealers is substantially adverse to

competition. *Schwinn, supra,* 388 U.S. at 375. The evidence shows that the answer to the question is that the refusal to deal, in itself, is not substantially adverse to competition.

368. Neither *Schwinn* nor *Continental TV, Inc.* v. *G.T.E. Sylvania,* 433 U.S. 36 (1977) (which reversed *Schwinn* in part), imposes upon GM any duty, absent an intent to monopolize, to deal with all willing customers. These cases are not the only relatively recent expressions of that concept. For example, in *Venzie Corp.* v. *United States Mineral Products Co.,* 521 F.2d 1309 (3rd Cir. 1975), the court upheld a refusal to sell to plaintiff the only fireproofing material that would be approved by the city of Philadelphia, which refusal caused the plaintiff to lose a building contract. The court said,

> To adopt plaintiffs' position would revolutionize the antitrust field. Every refusal by a franchisor to deal with one not a franchisee would automatically lead to a per se violation of the Sherman Act if the franchisor's product possessed the "desirability to consumers" or "uniqueness" which have been found sufficient to establish the necessary economic power of the tying product. . . . It would, moreover, amount to a substantial undercutting of the *Colgate* doctrine validating unilateral refusals to deal in the absence of a monopolistic purpose. Neither precedent nor policy suggests that such a reordering of the antitrust implications of business behavior is in order. 521 F.2d at 1318.

369. An important factor in *Venzie* was that defendant company made no effort to use the economic power it possessed as the sole manufacturer of the fireproofing material to enter the business of fireproofing application. 521 F.2d at 1317. This **[74]**is also true of Ford's actions in not selling crash parts to a wholesaler, as described in *FLM Collision Parts* v. *Ford Motor Co.,* 543 F.2d 1019 (1976). It also is true of GM's actions as shown here.

370. The desirability of not impinging unduly on the freedom to choose customers was expressed by Judge Hand in *Alcoa, supra,* 148 F.2d at 427–28. ". . . [I]t is of the essence of competition that the manufacturer or wholesaler should and does have wide freedom in maintaining the quality of his distribution system." This concept is found in *Colgate* and in Judge Hand's *Alcoa* decision. *Alcoa* is recognized as ". . . the most eloquent statement of the law of monopolization." *Borden/ReaLemon, supra,* 92 F.T.C. at 793.

371. One might argue, as Commission counsel seems to (CCPF 419), that there are no "other and equivalent brands" of new service GM crash parts available. It sounds plausible due to the fact that such parts are designed for use on GM vehicles only and are almost entirely manufactured by or for GM. Hence, it is argued that illegal monopolization exists in the refusal to deal directly with IBSs and IWs. But that argument ignores the "natural monopoly" each

manufacturer has over its products, which standing alone is not illegal. Further, if followed to its ultimate conclusion, the argument would lead to an assertion that a manufacturer is an illegal monopolist whenever, though free to do so, no one else produces parts to repair the manufacturer's product, regardless of whether it is an auto, camera, refrigerator, radio, TV set, watch or what-have-you. Neither antitrust nor trade regulation law goes that far.

372. There are a number of cases holding that a refusal to deal violates the Sherman Act when the monopolist was or would be in competition with the aggrieved party at some point in the distributive chain. See *Gamco, Inc.* v. *Providence Fruit and Product Building, Inc.,* 194 F.2d 484 (1st Cir.), *cert. denied,* 344 U.S. 817 (1952); *United States* v. *Otter Tail Power Company,* 410 U.S. 366 (1973); *United States* v. *Terminal Railroad Association of St. Louis,* 224 U.S. 383 (1912); *Associated Press* v. *United States,* 326 U.S. 1 (1945); *Kodak, supra; Klearfax, supra.* But GM is not in competition with the aggrieved parties here.

373. Complaint counsel contends that GM has a meaningful presence at the wholesaling level through the temporary interest it retains in new dealership franchises financed through its Motors Holding Divison (MHD) (CPF 441). I do not agree. This presence is *de minimis.* The franchisee runs the dealership and the interest GM has is limited in duration to an average of five to six years (RX 34) (RPF 187). Further, only a very small minority of GM dealers are MHD dealers and their number is decreasing. Between 1970 and 1977, the number of such dealerships decreased from 449 to 345 (RX 34). In 1977, the 345 [75]constituted only 3% of the 11,660 GM car dealerships (RX 34; RX 40). MHD dealerships only accounted for an estimated 4.3% of total GM dealer wholesale parts sales and an estimated 5.3% of total GM dealer body shop sales (RX 34; RX 38; RX 40).

374. What the court said of Ford in *FLM, supra,* is true of GM. There is no convincing proof ". . . that Ford, as distinguished from its dealers, had any significant share of that market, much less that it was using its monopoly at the manufacturing level to extend such a share." 543 F.2d at 1030.

375. Statements of Commission counsel regarding a symbiotic relationship between GM and its dealers notwithstanding (CPF 441), GM, any specific dealer, and the dealers as a group, are separate entities. Their actions in furthering their separate and mutual interests, as shown in the record, do not equate to a horizontal boycott, constituting either a *per se* or rule of reason violation of the Sherman Act or a spirit-or-intent violation of Section 5 of the FTCA.

376. The fact that GM is a very large corporation (Findings 62 and 65) has been considered. But size in itself does not create an unlawful monopoly and successful business operation doesn't either. To hold otherwise would frustrate the principal purpose of the antitrust laws, which is to preserve a system of free competitive economic enterprise and to protect the public against the evils of monopoly and monopoly power which unreasonably suppress or restrain interstate trade or commerce. *Kansas City Star Company* v. *United States,* 240 F.2d 643, 658 (8th Cir. 1957), citing 58 CJS, Monopolies Section 18. However, as well as assuring to the consumer the benefits flowing from free competition, another significant purpose of the antitrust laws is to protect the individual businessman. See Judge Bazelon's dissent in *Packard Motor Car Co.* v. *Webster Motor Car Co.,* 243 F.2d 418, 422 (D.C. Cir. 1957).

377. Insofar as the system GM uses for distributing crash parts is concerned, no persuasive evidence has been introduced of either a predatory intent or substantially adverse effect on competition attributable to the refusal to sell new GM crash parts to anyone other than GM dealers. The evidence *does* indicate that GM uses its system to sell crash parts exclusively through its dealers because of their mutual interest in crash parts being readily available (Findings 59 and 94), and that GM does not set or monitor the prices at which crash parts are sold (Finding 198).

378. Contrary to Commission counsel's view, I do not believe *The Peelers Co.,* 65 F.T.C. 794, *aff'd in part, sub. nom. La Peyre* v. *F.T.C.,* 366 F.2d 117 (5th Cir. 1966), is precedential. In that case respondent engaged in deliberate and obvious price discrimination between two groups of customers (processors on the west coast and those on the southern coast), **[76]**in the leasing of shrimp peeling equipment based on the customers' location, clearly with the goal of protecting its *own* canning interests at one of the locations. 65 F.T.C. at 839. The predatory motives found in that case are not present here.

379. I also believe that *FTC* v. *Texaco,* 393 U.S. 223, (1968), *Atlantic Refining Co.* v. *FTC,* 381 U.S. 357 (1965), and *Shell Oil Co.* v. *FTC,* 360 F.2d 470 (5th Cir. 1966), the so-called TBA cases, are not dispositive. The Supreme Court and the Fifth Circuit stated that certain marketing arrangements for tires, batteries, and accessories were illegal because the oil companies received commissions from leading tire companies for coercing the oil companies' franchised gasoline stations into buying their stock of those products from the tire companies. The analogy between the practices found in the TBA cases and GM's wholesale compensation plan to induce dealers to sell to IBSs at dealer net is too tenuous to support a coercion theory here.

I am convinced, however, of the illegal nature of the wholesale compensation plan as distinguished from GM's (1) monopoly power over its crash parts as well as (2) the distribution system itself.

Does GM's Relationship With Its Dealers Constitute A "Contract, Combination or Conspiracy" In Violation of Section 1 of The Sherman Act?

380. Commission counsel contends that GM reached a ". . . mutual understanding and agreement with its dealers, that GM would refuse to sell service GM crash parts to IWs and IBSs [and that this agreement] violates Section 1 of the Sherman Act and Section 5 of the Federal Trade Commission Act under either a vertical combination analysis, rule of reason analysis, or horizontal combination analysis [citations omitted] (CCPF 398). But, as pointed out by counsel to GM, there is no evidence of any agreement, tacit or formalized, between GM and its dealers that would restrict GM from selling its service crash parts to nondealers, and there is no persuasive evidence in the record indicating that GM's refusal to do so resulted in any way from dealer pressure (RB 21).

381. In support of the claim of a vertical combination in violation of Section 1 of the Sherman Act, *Klor's Inc.* v. *Broadway-Hale Stores, Inc.,* 359 U.S. 207 (1959) and *Hershey Chocolate Corp.,* 28 F.T.C. 1057 (1939), *aff'd,* 121 F.2d 968 (3d Cir. 1941), are cited by Commission counsel, but they are inapplicable to this case.

382. In *Klor's,* respondents were a chain of department stores and ten national manufacturers and their distributors. The evidence established that a conspiracy existed and that action was taken to keep the manufacturers from selling to Klor's, or to make such sales only at discriminatory prices and with highly unfavorable terms. 359 U.S. at 208. Justice Black [77]found that Broadway-Hale used its "monopolistic" buying power to induce the manufacturers to agree to its plan. 359 U.S. at 209. In addition, he expressly distinguished the plan from a situation where a manufacturer and a dealer agree to an exclusive distributorship. 359 U.S. at 212. No analogous situation—of GM bowing to dealer's clout—was shown in this case. To the contrary, GM did offer, in its settlement proposal of July 11, 1975, to sell directly to IBSs, despite strong dealer opposition (Findings 299 and 300) (RPF 229–239). Commission counsel's reliance on *Hershey,* also does not support his position. In that case, Hershey agreed to sell vending machine size bars of its product only to the three largest vending machine companies in order to keep their business. There is no evidence in this record showing that GM

dealers possessed the buying power to induce GM to act involuntarily. *Hershey Chocolate,* 121 F.2d at 970 (RB 21).

383. In selling service crash parts only through franchised dealers, GM has not shown the intent to limit competition which was present in the situations described in the cases referred to on pages 72 and 73. Nor has GM in any way restricted the freedom of its dealers to do business with any customers with whom *they* might wish at whatever price *they* select. On the contrary, the wholesale compensation plan was created to encourage and to induce franchised dealers to sell to IBSs, who are, in essence, the dealers' competition (Finding 35).

384. Under the Sherman Act, contracts and combinations which are an unreasonable restraint of trade are prohibited and violations of that act have long been held to be violations of the Federal Trade Commission Act. *F.T.C.* v. *Cement Institute,* 333 U.S. 683, 691–92 (1948). Certain practices ". . . because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the harm they have caused or the business excuse for their use." *Northern Pacific Railway Co.* v. *United States,* 356 U.S. 1, 5 (1958). Price fixing agreements, divisions of markets, group boycotts, and tying arrangements are practices which are illegal *per se. Northern Pacific,* 356 U.S. at 5. However, the actions of GM and its dealers clearly neither rise to a group boycott, nor are they otherwise "pernicious". GM's actions have therefore been examined under the "rule of reason", *i.e,* whether the negative effects of GM's system of crash parts distribution outweigh any positive benefits to competition. Commission counsel suggests that GM's system provides no benefits to competition (CCPF 406).

385. Vertical restrictions are usually justified on the basis of the stimulation of interbrand competition even as they may work to reduce intrabrand competition. Commission counsel contends that because GM, for all practical purposes, has a 100% share of the relevant product market, interbrand competition [78]does not exist and therefore cannot be benefitted by the vertical restraints GM has included in its system of distribution (CCPF 403).

386. Counsel to GM responds, and I agree, that the object of the system, to provide optimum serviceability for GM automobiles so that owners will be favorably disposed to buying another one, is another benefit to be weighed when considering the negative effect of such restrictions (RB 19, 20).

387. The Supreme Court has recognized the existence of other "redeeming virtues" derived from the use of vertical restraints

which enable one manufacturer to compete more effectively against another. Such restraints can be used to

> induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. *Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's good will and the competitiveness of his product.* Because of market imperfections such as the so-called free rider effect these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did. [Emphasis added].

GTE/Sylvania, supra, 433 U.S. at 55.

388. As the Supreme Court stated in *GTE/Sylvania,* a manufacturer generally will prefer a competitive market situation, because this will: (1) lower retail prices by lessening the margin between the price to dealers and the dealers' resale price; and (2) increase sales and revenues to the manufacturer. *GTE/Sylvania, supra,* 433 U.S. at 56, n.24.

389. In addition, the fact that GM's system is the one in use by all domestic and foreign competitors (RPF 102–105, 111–119), indicates that the automobile manufacturing industry adopted the system because it believed it to be the most efficient one.

390. I am not persuaded by Commission counsel's argument that GM, "secure in its position as a monopolist," would sacrifice efficiency in its crash parts distribution system merely to build dealer loyalty and thus increase new car sales. Loyalty to GM is not the major incentive for dealers to maximize new car sales. The financial benefit to dealers who sell additional cars is more than sufficient. In addition, and as noted above, an efficient system of repair of products is a substantial lure for prospective buyers. It is difficult to [79]believe that GM would conspire with its dealers to the detriment of its own sales of new automobiles.

391. Counsel to GM points out that if any "joint action" can be found between GM and its dealers, it was for the purpose of influencing the government, and thus protected under the "*Noerr-Pennington* doctrine" (RB 22). *Eastern Railroad Presidents Conference* v. *Noerr Motor Freight, Inc.,* 365 U.S. 127 (1961) and *United Mine Workers of America* v. *Pennington,* 381 U.S. 657 (1965). The court in *Noerr-Pennington* established that no violation of the Sherman Act will be found where parties have merely attempted to influence the enforcement or passage of laws, even if the result is to injure their competitors. 365 U.S. at 139.

392. Commission counsel contends that the fact that GM and NADA have discussed crash parts distribution for many years (CCPF

281, 282) indicates that settlement proposals to the FTC were not a factor, and therefore *Noerr-Pennington* is not applicable (CCRB at 117). Obviously GM and its dealers, in the relationship of franchisor and franchisees, have many common interests which require communications concerning a great many matters, not the least of which, no doubt, is crash parts. The fact that they have had discussions on this topic is insufficient evidence of a conspiracy to convince me that a violation of the antitrust laws resulted. GM's submission of proposals to the FTC which called for sales by GM to IBSs, which the dealers oppose very strongly (Finding 300) is further evidence that no conspiracy existed.

393. The importunings of GM and its dealers addressed to the FTC *are* protected by the *Noerr-Pennington* doctrine. *Mt. Hood Stages, Inc.* v. *Greyhound Corp.*, 555 F.2d 607 (9th Cir. 1977), *vacated and remanded on other grounds,* 437 U.S. 322 (1978). Other cases cited by Commission counsel limiting this doctrine are inapposite. On the basis of the evidence here, GM and its dealers should not be faulted insofar as their actions oriented toward mutual interests are concerned.

Is The Wholesale Compensation Plan GM Uses Illegal?

394. The answer to the question in the caption is "Yes". GM's wholesale compensation plan is unfair. "The essence of unfairness in an exclusive arrangement as a marketing tactic is the actual foreclosure of *business rivals* from consuming markets, thereby *denying them opportunity to compete on even terms.* [emphasis added]." *Attorney General's Committee Report, supra,* at 148. The key words are "denying them opportunity to compete on even terms," in other words, discrimination. The quotation is not on all fours with the instant situation because the business rivals in question are those of the dealers rather than of GM. Even so, the "denial" IBSs suffer stems from GM's wholesale compensation plan and thus violates Section 5 FTCA. [80]

395. Counsel to GM takes the position that the Complaint does not charge that the wholesale compensation plan brings about discrimination. I do not agree. Paragraph 13, in essence, sets forth a charge that IBSs frequently pay more for new service GM crash parts than do GM dealers, and paragraph 16(e) alleges that GM uses "disparate" wholesaling incentives in distributing such parts. In addition, the "Notice of Contemplated Relief" on the last page of the Complaint should have alerted counsel to GM to the fact that if the Commission concluded from the record developed that GM is in

violation of Section 5, it might order such relief as is supported by the record and is necessary and appropriate, including, but not limited to the "Notice Order".

396. Furthermore, there is no requirement that a complaint in an administrative proceeding must enumerate precisely every event to which an administrative law judge may initially or the Commission may thereafter attach significance. The purpose of the administrative complaint is to give the responding party notice of the charges against him. 1 *Davis Administrative Law Treatise* Sections 8.04–8.05 and cases cited therein. The complaint is adequate if ". . . the one proceeded against be reasonably apprised of the issues in controversy, and any such notice is adequate in the absence of a showing that a party was misled." *Cella* v. *United States,* 208 F.2d 783, 789 (7th Cir. 1953), *cert. denied,* 347 U.S. 1016 (1954); *Swift & Co.* v. *United States,* 393 F.2d 247, 252 (7th Cir. 1968).

397. As the Commission case unfolds there must be ". . . reasonable opportunity to know the claims of the opposing party and to meet them." *Morgan* v. *United States,* 304 U.S. 1, 18 (1938). There is no question here whether GM knew the claims of Commission counsel or that GM had ample opportunity to meet them. GM *did* know and *did* address them.

398. The plan GM uses for distributing crash parts, regardless of whether a part is eligible for wholesale compensation, results in dealers as a class paying GM less for a crash part than IBSs as a class pay the dealer for the part, even though they may be competitors in repairing crash damaged vehicles. Dealers' final costs for parts vary because: (1) the part may be used in the dealer's body shop rather than resold (Finding 77); (2) a dealer may stock parts and have certain expenses which another dealer does not; or (3) a dealer may not stock and he will have a different set of expenses (Finding 79). No doubt there are other significant factors, but without having detailed information regarding the operations of particular dealers and IBSs it is not possible to determine precisely what the expenses to each in *particular* competitive situations are, and what the final cost of a *particular* part is. Such precise data is not needed to support the conclusion that generally IBSs pay more than GM dealers and [81] otherwise are disadvantaged and discriminated against.

399. Dealers buy for 40% off GM's list price (Finding 119). They can get an additional discount depending on whether they order a part on the PAD (Findings 120 and 190(1)) or are entitled to a rebate because they resold the part in a way qualifying for wholesale compensation (Finding 76). They also may have freight prepaid by

GM on routine orders (Finding 190(1)(2)(3)) and inevitably enjoy faster delivery service than do IBSs.

400. In contrast, IBSs buy parts at 25% to 40% off GM's list price, averaging about 32% (Finding 124). They cannot get the additional (PAD) discount for the way in which they order or a rebate for a particular type of resale. They often must pay for delivery and there is an inherent delay factor in the time required for delivery (Finding 131).

401. To the extent that a dealer actually performs real wholesaling functions in doing business with IBSs, *i.e.,* maintaining an inventory, taking orders, ordering from GM, receiving parts and delivering them, extending credit, etc., a particular dealer's final cost for a part may be increased or decreased, but there is very little uniformity amongst dealers in performance of these functions. Some stock, many don't (Finding 102). Some have special order taking and placing facilities, others don't. (Finding 132). Thus, there may be significant variations in the ultimate "cost" of a part to a particular dealer, but there is no variation in the price *he* pays GM: 40% off list plus on routine orders the PAD discount, freight prepaid, and the rebate for wholesaling in accordance with the plan (Finding 119, 120, 190(1)(2)(3) and 77). The result is that dealers, in general, are favored and IBSs are discriminated against.

402. The plan also discriminates among GM dealers, because those who sell or who may wish to sell a crash part for a make of GM automobile other than the one or more for which they are franchised (Finding 104) are not eligible to claim wholesale compensation. No doubt this prohibition inhibits most dealers from selling crash parts across franchise lines. If a dealer *does* cross his franchise line(s) his cost for the crash part is higher than the cost to any competing franchised dealer. (Finding 77).

403. Discrimination of this sort insofar as the antitrust laws are concerned, *i.e.,* the Sherman and Clayton Acts, is not clearly illegal. The prevention of such disfavoring/discriminating, however, is within the spirit of those laws, because it creates an undue impediment to the competition IBSs can offer to GM dealers and to competition among some GM dealers. The wholesale compensation plan makes it impossible for IBSs, as a class, to be on equal footing with GM dealers as [82]a class. The same is true of franchise-crossing dealers and those GM dealers against whom they compete. Such situations may be appraised by the Commission and ultimately by the courts simply as being fair or unfair. *FTC* v. *Gratz,* 253 U.S. 421, 427 (1920).

404. The Commission has broad powers to declare trade practices

unfair. That power is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts, even though such practices may not actually violate those laws. *FTC* v. *Brown Shoe Co.,* 384 U.S. 316, 321 (1965).

405. In its Statement of Basis and Purpose of Trade Regulation Rule 408, "Unfair or Deceptive Advertising and Labeling of Cigarettes In Relation to the Health Hazards of Smoking", the Commission described the factors it would consider in evaluating what constitutes unfair or deceptive practices. These, in essence, were: (1) whether the practice, regardless of legality, offends public policy, *i.e.,* is within the penumbra of some common-law, statutory, or other established idea of fairness; (2) whether the practice is immoral, unethical, oppressive or unscrupulous; and (3) whether it causes substantial injury to consumers, or competitors or other businessmen. 29 Fed. Reg. 8324, 8355 (1964). The wholesale compensation plan GM uses, among other things, (1) is within the pneumbra of trade regulation and antitrust law to the effect that commercial discrimination is not fair; (2) is unduly oppressive to IBSs; (3) injures consumers by contributing to rises in price; (4) injures IBSs by discriminating against them, and (5) by paying wholesale compensation to nonstocking dealers, who do not perform that warehousing function in distributing crash parts, discriminates against stocking dealers. See also *F.T.C.* v. *Sperry & Hutchinson Co.,* 405 U.S. 233, 239–245 (1972) and *Gratz, supra,* 253 U.S. 421, 427.

GM's No Public Interest Defense

406. In its Answer to the Complaint, counsel to GM denied that the Commission had reason to believe that use of GM's crash parts distribution system is a violation of the law and denied that these proceedings were in the public interest (Answer, par. I). The Commission has said, however, that such defenses go to the mental processes of the Commissioners and will not be reviewed by the courts. Once the Commission has resolved these questions and issued a complaint, the issue to be litigated is not the adequacy of the Commission's pre-complaint information or the diligence of its study of the material in question but whether the alleged violation has in fact occurred. *Exxon Corporation,* 83 F.T.C. 1759 at 1760 (1974) (Order denying respondent's motions for reconsideration of Commission's prior denial of respondents' motion to dismiss complaint).

407. It also should be mentioned that in *Herbert R. Gibson, Sr.,* 90 F.T.C. 275 (1977) (Order denying [83]respondent's motion to dismiss for lack of public interest), the Commission held that administrative

law judges lack authority to rule on ". . . questions pertaining to the Commission's exercise of administrative discretion." In that case, the existence of public interest was questioned as part of a motion to dismiss. The *Exxon* decision, noted above, and a number of other cases were cited.

The Commission's Power To Charge Only One Respondent and To Effect Remedies

408. The fact that the Commission chose to issue a complaint only against GM when all the other vehicle manufacturers doing business in the United States use the same system (Finding 34) is not significant. The Commission has the power to enter an order against one firm that is using an industry-wide illegal trade practice. *F.T.C.* v. *Universal Rundle Corp.,* 387 U.S. 244 (1967); *Standard Oil Co. of California* v. *United States,* 337 U.S. 293 (1949); *Moog Industries Inc.* v. *F.T.C.,* 355 U.S. 411 (1958).

409. There have been no instances where a Commission order has been set aside simply because it was directed against a single violator in the face of industry-wide violations. *Rabiner & Jontow, Inc.* v. *F.T.C.,* 386 F.2d 667, 669 (2d Cir. (1967)). However, the Commission's orders must serve a remedial and not a punitive purpose. *F.T.C.* v. *Ruberoid Co.,* 343 U.S. 470 (1952); *Niresk Industries, Inc.* v. *F.T.C.,* 278 F.2d 337 (7th Cir.), *cert. denied,* 364 U.S. 883 (1960). Further the Commission may not issue oders which would arbitrarily destroy one of many violators in the market. *Universal-Rundle, supra,* 387 U.S. at 251. A "reasonable evaluation" of the competitive situation must be made to ascertain whether a particular order would be contrary to the purpose of the laws sought to be enforced. 387 U.S. at 251–52.

CONCLUSIONS

410. GM is engaged in commerce and affects commerce as "commerce" is defined in the Federal Trade Commission Act.

411. GM has not abused its monopoly in, and monopoly power over, the distribution of new GM crash parts, as defined in the Complaint.

412. GM's refusal to sell crash parts directly to anyone other than GM dealers is lawful.

413. Due to the disfavoring of and discrimination against IBSs and some GM dealers, and in violation of Section 5 of the Federal Trade Commission Act, the wholesale compensation plan GM uses

unfairly hinders and injures competition in the distribution of new GM crash parts. [84]

THE REMEDY

414. The order attached is intended to be remedial and is not contrary to the purpose of the Federal Trade Commission Act. It is not punitive, certainly will not destroy GM, and I believe it to be just. It is in harmony with both the Federal Trade Commission Act and the antitrust laws.

415. Latitude is necessary in framing orders for ". . . the Commission alone is empowered to develop that enforcement policy best calculated to achieve the ends contemplated by Congress and to allocate its available funds and personnel in such a way as to execute its policy efficiently and economically." *Moog Industries, supra,* 355 U.S. at 413. But the latitude and the broad authority which the Commission has in framing orders must be used with great care to achieve maximally and effectively ends "*to the interest of the public*" (15 U.S.C. 45(b)) which the Congress contemplated when the FTC Act was passed. The circumstances under which the wholesale compensation plan GM uses was implemented (Findings 29–55) and the unforeseen results of its implementation (Finding 417 below) emphasize the need for great care.

416. The evidence establishes that GM's use of the wholesale compensation plan must be stopped because it illegally discriminates against IBSs and discriminates between stocking and nonstocking GM dealers and may do so with regard to wholesaling GM dealers who cross franchise lines.

417. The plan has not achieved the price parity between GM dealers and IBSs which was the objective when it was made applicable to crash parts in 1968 (Finding 54). Most importantly it has increased costs to consumers and has not lowered prices to IBSs (Finding 54). It is expensive to administer, requires auditing, is susceptible to fraud, and does not reward volume buyers for the costs they save GM (Tr. 14002–03; 14013–14) (CCPF 307, 310–14, 352).

418. Although these adverse effects are clear, there is insufficient evidence in this record regarding the provisions best suited for a nondiscriminatory plan for distribution of crash parts. I am not convinced that the relief Commission counsel advocates in the Complaint, (in essence, opening GM's warehouses to everyone except individual owners of vehicles) would be the proper remedy. For example, allowing anyone to buy from GM warehouses at nondiscriminatory prices may cause more problems than it solves.

On the other hand it might solve all the problems. Or, the definitions of crash parts and components and applicability of the plan may be too limited. It may be unwise to define "auto" and "light trucks". Perhaps crash parts for more vehicles should be included in the plan or the definitions Commission counsel proposes may be too restrictive. [85]There may or may not be a justification for continuing to categorize crash parts into compensable and noncompensable groupings. No doubt there are other possible problems.

419. The order below, in practical effect, calls for a GM-Commission staff, cooperatively devised plan to bring about compliance with the Federal Trade Commission Act. It will enable GM, which has the best information about its needs in crash parts distribution, and the Commission and its staff, to see to it that an effective and lawful plan is devised. There was Commission staff involvement in GM's adoption of the wholesale compensation plan it uses now (Findings 29–55). However, the plan in operation has proven to be neither lawful nor to the interest of the public. Commission oversight with the benefit of the record of an adjudicative hearing is the added factor which was not present before and will lead to the necessary changes.

420. Accordingly, and pursuant to authority contained in Commission Rules 3.42(c) and 3.51(b) the following order is entered. [86]

Order

I

It is ordered, That GM is to submit a detailed report to the Commission within 30 days of the date on which this Order becomes final describing a nondiscriminatory plan which it proposes to use for distributing new GM crash parts.

II

It is further ordered, That within 30 days of the date of approval by the Commission of the new plan GM is to implement its use.

III

It is further ordered, That annually within ten days prior to the anniversary of the date this Order becomes final, for a period of five years, GM is to submit in writing to the Commission a report setting forth in detail the manner of GM's compliance with this Order.

IV

It is further ordered, That Commission approval of the Plan does not relieve GM of the obligation to comply fully, and in the future, and with respect to any changes in practice which GM may from time to time implement in connection with its sales of service GM crash parts, with all of the requirements of Paragraph 1 of this Order. After the Commission has approved it, GM is not to change any of the terms or conditions of sale set out in the Plan (excluding prices) without first (a) giving 30 days' prior written notice of each such change to the Commission, (b) to all GM customers who purchase new GM crash parts, and (c) publishing a description of each such change in [87]Automotive News or a similar publication(s) with wide circulation among independent wholesalers and independent body shops.

Opinion of the Commission

By Bailey, *Commissioner:*

This case presents the question of whether General Motors Corporation (GM) has violated Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45), by its use of a selective distribution system for new crash parts for GM automobiles and light trucks (hereinafter "crash parts"). Crash parts, which will be described in more detail below, are a type of automobile replacement part: true to their name, they are used to restore those parts of the car body most commonly damaged in accidents, such as fenders, doors, and hoods. GM is the sole source for new crash parts compatible with GM vehicles; it has a long-standing policy of selling its new crash parts only to its franchised dealers. As a result of this policy, any person who wants a new GM crash part for installation or resale purposes must get it from a GM franchised dealer.

Particularly disadvantaged by GM's policy are the independent body shops (IBS), specialists in automobile body work, whose business depends upon a supply of crash parts. IBS are supplied new GM crash parts by GM-franchised dealers, who are also the IBS' competitors for collision repair business. Despite GM's efforts to encourage its dealers to resell crash parts to the IBS at cost, the record clearly shows that IBS as a class pay more for crash parts than do their rival dealer-installers. [2]

GM's selective distribution system for crash parts also disadvantages another class of businesses, but in this case the disadvantage is purely theoretical. The businesses in question are the independent

wholesale parts distributors (IWs) who currently sell automobile replacement parts which are available from more than one manufacturer. Examples of these multisource parts are spark plugs, shocks and glass. There is some evidence in the record that IWs would be interested in wholesaling GM crash parts, thereby introducing competition to a business which is presently the sole domain of GM.

This appeal reaches us with a lengthy history: three investigations from the mid-1960's until issuance of the Complaint on March 22, 1976, two years of discovery, and 82 days of hearings which produced a bulky record in no little state of disarray.[1] In any proceeding as long and involved as this one, it is possible to pick away at the details and find numerous flaws and inconsistencies. Both respondent and complaint counsel have been quick to explore every one. But in appellate review our function is broader. We look to the entire record.

The primary difficulty with this case is not in perceiving that GM's selective distribution system disadvantages IBS in the business of installing crash parts or disadvantages IWs in the business of wholesaling crash parts. The problem is, rather, whether these disadvantages translate into the sort of injury to competition which is cognizable under the antitrust laws. The difficulty in arriving at a determination on that question can be seen in the fact that complaint counsel argued at trial and on appeal that the system amounts both to a vertical and a horizontal boycott, several types of attempted monopoly, and an abuse of monopoly power. The Administrative Law Judge (ALJ) rejected all of complaint counsel's arguments as to the illegality [3]of the system as a whole. (IDF 380, 411, 412)[2] However, he did, *sua sponte,* find that one component of the

[1] The record contains approximately 8,400 exhibits and the testimony of 84 witnesses, running to approximatey 16,285 pages of transcript. It does not contain any sort of document list, much less any table referencing testimony authenticating, identifying or explaining a given document. Moreover, many documents were received piecemeal—part as respondent's exhibit, part as complaint counsel's exhibit, sometimes part as the ALJ's exhibit—without any clue as to where the remaining portions of an exhibit could be found. This disarray created no little problem in reviewing this case.

[2] The following abbreviations will be used in this opinion:

IDF	– Initial Decision Finding Number
Tr.	– Transcript Page Number, preceded by witness' name
ALJX	– Administrative Law Judge's Exhibit Number
CX	– Complaint Counsel's Exhibit Number
CAd	– Complaint Counsel's Admissions
CPF	– Complaint Counsel's Proposed Finding
CRF	– Complaint Counsel's Reply Finding
CB	– Complaint Counsel's Post Trial Brief
CRB	– Complaint Counsel's Post Trial Reply Brief
CAB	– Complaint Counsel's Appeal Brief
CAAB	– Complaint Counsel's Appellate Answering Brief
CARB	– Complaint Counsel's Appellate Reply Brief
CASB	– Complaint Counsel's Appellate Supplemental Brief on the *Reuben Donnelley* decision

(Continued)

crash part distribution system, known as the Wholesale Compensation Plan (WCP), was unfair and a violation of Section 5. (IDF 413) [4]

We affirm the ALJ's reasoning and conclusions of law that GM has neither attempted to monopolize distribution of crash parts, nor engaged in vertical or horizontal boycotts effecting limitations on crash parts distribution. Like the ALJ, we conclude that GM has not abused its monopoly power over crash parts distribution, but we reach our holding by a different and more complex process. The ALJ interpreted the precedents as giving every supplier, even one having monopoly power in the relevant market, an unassailable right to refuse to deal with willing customers. Since he found that GM has no predatory or monopolistic purpose in its choice of distribution system, his analysis began and ended at this point. Our approach is to determine if this case presents one of those rare situations where a supplier with monopoly power over an essential product has a duty to deal with all customers. This requires a rule of reason analysis which weighs the injury to competition against the supplier's business justification for its actions. In making such an analysis our first step is to determine the extent of harm caused by the refusal to deal. Only substantial injury to competition compels us to look further and assess the business justification for the refusal to deal. The economic self-interest of the monopolist is always an important consideration, but becomes particularly compelling when the harm shown to competition is not clearly and directly traceable to the refusal to deal, or can just barely be characterized as substantial. In this case, although we find injury to independent bodyshops caused by the effects of General Motors' selective distribution system for

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RX	– Respondent's Exhibit Number
RAd	– Respondent's Admissions
RPF	– Respondent's Proposed Finding
RRF	– Respondent's Reply Finding
RB	– Respondent's Post Trial Brief
RRB	– Respondnet's Post Trial Reply Brief
RAB	– Respondent's Appeal Brief
RAAB	– Respondent's Appellate Answering Brief
RARD	– Respondent's Appellate Reply Brief
RASB	– Respondent's Appellate Supplemental Brief on the *Reuben Donnelley* decision
INX	– Intervenor NADA's Exhibit Number
INPF	– Intervenor NADA's Proposed Finding
INRF	– Intervenor NADA's Reply Finding
INB	– Intervenor NADA's Post Trial Brief
INRB	– Intervenor NADA's Post Trial Reply Brief
IAB	– Intervenor ASC's Post Trial Brief
IARN	– Intervenor ASC's Post Trial Reply Brief
IAAB	– Intervenor ASC's Appeal Brief
IAASB	– Intervenor ASC's Appellate Supplemental Brief on the *Reuben Donnelley* decision

crash parts, we cannot say that that system causes any enduring weakness to the IBS as a class of competitors or that GM's choice of distribution system is arbitrary or without substantial business justification. Finally, we conclude that the WCP merely reflects and does not add in any way to the inequities which the selective distribution system imposes on the IBS and IWs. We reserve the ALJ in his finding that the WCP, as distinguished from the selective distribution system, injures competition in the distribution of new GM crash parts. Accordingly, the case is dismissed.

We adopt such of the ALJ's findings and conclusions as are consistent with the findings and conclusions set forth in this opinion. **[5]**

I. BACKGROUND

A. General Motors Corporation

Respondent General Motors Corporation needs little introduction. Since its organization in the early years of this century, it has grown to be the largest manufacturer of automobiles and light trucks in the United States. (IDF 56, 65) In addition, GM manufacturers a variety of products within the automotive and transportation fields; but the primary interest of both GM and its franchised dealers is in selling cars and trucks. (IDF 57, 58) In 1976, GM-manufactured automobiles accounted for approximately 45.5% of total U.S. automobile registrations and GM trucks for 42% of total truck registrations. (IDF 62) GM manufactures and sells in the U.S. five "lines" or principal makes of automobiles: Chevrolet, Pontiac, Oldsmobile, Buick, and Cadillac. (IDF 57) There are 12 different body sizes available for GM-manufactured automobiles as a whole, and within each line a multiplicity of body models, which often change from year to year. (IDF 62) This stylistic variety significantly influences both the demand for new crash parts and the structure of the distribution system which answers that demand.

B. Crash Parts

Crash parts are a type of automobile replacement part. They constitute the cosmetic, visible, outer parts of a car which give it its distinctive style, and are expected to last the lifetime of the car under normal conditions. They are generally replaced only as a result of collision damage. They are therefore distinguishable from electrical or mechanical parts which are installed in the internal functional system of the car and, as a result of either wear or failure,

are replaced on a maintenance basis. (IDF 145) The Complaint lists as crash parts:

> . . . any one or all of the following products: fenders, grilles, bumpers, hoods, deck lids, doors, quarter panels, rear end panels, rocker panels, lamp assemblies, wheel opening panels, fenders and rear end caps, tail gates, radiator supports and shrouds, and mouldings, including inner and outer panels and all components of these products as well as all parts necessary to attach the aforesaid to the bodies of automobiles and light trucks. (Complaint, Par. 1(d)) [6]

Crash parts are non-standard parts tailored to fit specific cars, by model and year. Thus a crash part of a Ford car will not fit a GM car; nor are crash parts generally interchangeable among GM automotive lines; nor among different models within a line; nor even, at times, between different years of the same model. (IDF 71, 144) Small wonder, then, that the GM Parts Division carries about 32,000 crash parts numbers. (IDF 167) Crash parts as a class are bulky and require considerably more space for storage than mechanical or electric replacement parts. Crash parts also require especially careful treatment during distribution as they are easily marred and hard to handle. (IDF 74)

All GM crash parts are produced, either by GM or by independent manufacturers to whom GM has subcontracted the work, from tooling owned by GM. (IDF 68) Crash parts sales, although only a small portion of GM's total revenue, are significant: GM computed the gross dollar value of domestic shipments in 1975 as approximately $314 million (CX 7407A) and complaint counsel's undisputed calculations for 1977 produced a figure of approximately $548.8 million. (CPF 15, 46, 306)

Although GM has made no efforts to inhibit others from entering the crash parts manufacturing business, none have done so. (IDF 151) This requires some explanation. The total demand for crash parts is high. (IDF 152) Demand for individual crash parts is fairly inelastic, being stimulated by the vagaries of collisions. (Benston Tr. 16070; Murphy Tr. 10286) The demand for each individual part is generally quite modest. This is due to the low probability that a vehicle will require replacement of a particular crash part during its lifetime. (IDF 152, 153) GM usually starts production of a half year's supply of crash parts for automobiles before introducing the new model, and keeps sufficient inventories of crash parts for each model for 7 to 12 years. (IDF 80, 84) It is not economically feasible for GM to produce total anticipated crash parts needs in one production run, much less store such a mass of parts. (IDF 154) Thus, the bulk of replacement crash parts are built over the lifetime of the vehicle as warranted by inventory needs and warehouse space. This process

requires that dies used in manufacture of new cars be retrieved, steam cleaned, reconditioned—in some cases partially rebuilt—and then inserted into presses to run the required supply of crash parts. This is an expensive process because the runs are short-term and the technology is labor intensive. (IDF 156) [7]

Therefore, expensive as it is for GM, the process would be prohibitively expensive for anyone else. Tooling to manufacture GM crash parts can run to tens of millions of dollars. (IDF 149) However, the same dies which are required for service parts are used in the production of original equipment, enabling GM to spread the costs associated with crash part manufacture. (By GM's estimate, crash parts manufacturing costs amount to less than 15% of total tooling cost). (ALJX 9T) It is not difficult to understand why other manufacturers have shown no inclination to incur such large tooling costs simply to produce crash parts. In this market, GM's ownership of the dies used in the manufacture of new cars gives it a wholly natural and decisive competitive advantage over potential manufacturers of crash parts. (IDF 148)

In sum, considerations of scale economies and demand, rather than monopolizing conduct, explain the lack of competition in crash parts manufacturing.

C. General Motors Parts Distribution Systems

General Motors has two systems for distributing the automotive parts which it manufactures. (IDF 157) About 60,000 "maintenance type" parts, which can be used on both GM and non-GM cars, are sold to the independent aftermarket by GM's AC-Delco division. (IDF 158, 183–185) About 300,000 sheet metal and engine parts, which are applicable solely to GM cars, are sold exclusively to GM-franchised dealers by the General Motors Parts Division (GMPD). (IDF 158, 167) Crash parts, with only a very few exceptions, are not AC Delco parts, and are distributed solely through GMPD. (IDF 158, 165, 186)

To evaluate GM's business rationale for its choice of crash parts distribution system, the following points must be made. Of the total number of parts distributed by GMPD only 32,000 (approximately 10%) are crash parts. (IDF 167). GMPD makes no distinction between crash parts and all the other sole source parts which it distributes. (*Id.*) Moreover, all U.S. auto manufacturers and all foreign automobile companies that have been selling cars in the U.S. since the early 1960's distribute their crash parts in the same way that GM distributes its crash parts. (IDF 94) GMPD seems to specialize in the distribution of low demand, slow moving parts. 75% of its total inventory fits this description (IDF 175) as do from 65% to

77% of all crash parts, depending upon which GM study one reads. [8](*Compare* RX 20 with CX 7006D) As we shall see, many GM franchised dealers wholesale crash parts, but they tend to inventory only the fastest-moving parts applicable to their franchise line. Accordingly, most IBS complaints concern the difficulty of getting the low-demand, slow-moving parts, which must be specially ordered by the GM dealer from GMPD inventory and routed through the GM dealer for delivery to the IBS. (IDF 177, 178)

D. Crash Parts Installers: GM Franchised Dealers and the Independent Body Shops

The complexities of actual and potential systems for wholesaling crash parts are more easily understood after a brief review of the retail end of the distribution chain. Almost all body repair work on GM cars and trucks is done by GM dealers or the independent body shops. (IDF 100) In 1976 there were approximately 12,000 car and truck dealerships franchised by GM in the United States. (IDF 2) The primary business of these dealerships, like that of GM, is selling cars and trucks. (IDF 58) Each dealership has ready access to the crash parts applicable to its line, and at least 80% find it expedient to install crash parts as part of the ongoing service they offer on the cars they sell. (IDF 59, 69, 100; Bentson Tr. 15770) They do so for two reasons. First, body work on cars, including crash part installation, can be a profitable sideline. (Perkins Tr. 9916) Second, availability of parts and service, in an incondite way, affects a customer's decision to buy a new car. While the record contains no evidence that prospective new car purchasers specifically ask about crash parts availability, much less cost,[3] it does support the general proposition that dealers feel that the reputation of their body shops helps make a sale. (Perkins Tr. 9914; Bentson Tr. 15751–52, 15793) GM has apparently also [9]concluded that parts availability can affect new car sales, but that the precise correlation is peculiar to each dealership. The standard GM franchise agreement requires the dealer to carry in stock parts and accessories "adequate to meet customer demands," but specifies neither dollar amounts nor number of items to be inventoried. (IDF 95)

In 1972 there were over 32,000 IBS in the United States. (RX 38, 39) IBS are generally smaller operations than GM dealer body shops, often being one or two man operations. (IDF 264) While GM dealers tend to specialize in repairing the models they sell, IBS do body work on all types of vehicles. (IDF 100) The record does not show what

[3] Most car buyers count upon insurance to cover damage expenses, and so devote little thought to future repair costs at time of purchase. (IDF 60)

portion of IBS revenues are provided by sales and installation of GM crash parts; our rough estimate is around 20%.[4] IBS purchase their new GM crash parts from GM dealers, generally for more than these dealers pay GM for the identical parts. It was IBS complaints about the wholesale cost discrepancy on crash parts which launched this case. (IDF 29)

Both the IBS and GM dealers were represented in this proceeding. The Automotive Service Counsel, which had over 2,000 IBS members in 1978, filed briefs. (IDF 15) The National Automobile Dealers Association (NADA) to which 70% of all GM dealers belong, participated in the trial and filed briefs. (IDF 14)

E. GM Franchised Dealers as Crash Parts Wholesalers; the Wholesale Compensation Plan

GM dealers, as far as the record shows, have always been free to sell the crash parts which they purchase from GM. GM has not and does not attempt to control its dealers' crash parts sales with respect to price, customer or territory. (IDF 198) GM does suggest wholesale prices for crash parts. (IDF 197)

GM has intruded upon its dealers' wholesaling freedom to the extent of providing incentives for the sale of crash parts to IBS. Under the Wholesale Compensation Plan (WCP) adopted in 1968, GM rebates voluntarily to participating dealers [10]a percentage of the cost of crash parts sold to IBS.[5] The purpose of this plan which was worked out after discussions with the Commission staff and adopted also by Ford and Chrysler (ALJX 17–5) was to overcome the crash parts wholesale price disadvantage faced by the IBS. Under the plan, dealers are supposed to wholesale crash parts at cost, making their profits wholly from the rebate, and thus putting the IBS at parity with GM dealers on crash part cost. (IDF 34, 76) Unfortunately, many GM dealers eschew such altruism, seeing in the plan an opportunity for "double dipping"—taking the WCP rebate from GM while selling crash parts at a markup to the IBS.

The extent and effect of the wholesale cost variance between dealers and IBS will be explored in detail later in this opinion. For now it is important to note that GM cannot force its dealers to wholesale crash parts at cost, or any other price, without laying itself open to a charge of resale price maintenance. Therefore, the dealers' exploitation of the WCP is of the same nature as their basic freedom to dispose of goods which they own in any matter they see fit. It does

[4] *See infra* note 74.

[5] The technical ins and outs of the WCP and dealer ordering methods for crash parts are exceedingly complex. They will be highlighted as necessary in this opinion, but the reader is referenced to IDFs 75–79, 82, 104–112, 190–196 for a complete description of the plan's operation.

not interfere with a dealer's freedom to decide whether or not to wholesale. (IDF 103) There is a conflict in the record as to the number of GM dealers who engage in "meaningful" wholesaling,[6] but no indication that the WCP has changed this percentage in any way, or altered the geographic dispersion of crash parts throughout the United States. In short, the WCP did not introduce into GM's crash parts distribution system any fundamental new disadvantages to the IBS.

II. LEGAL ANALYSIS

A. Conspiracy Theories

Complaint counsel argue that GM's exclusion of the IBS and IWS from its crash parts distribution system is the result of a conspiracy between GM and its dealers. That conspiracy, Janus-like, is alleged to be either horizontal, with GM a willing co-conspirator, or vertical, with GM a coerced partner. Thus, before considering whether any agreement exists we must determine whether GM and the GM dealers share the same niche in the crash parts distribution chain. [11]

1. Horizontal Theories

(a) Presence through the Motors Holding Division

The horizontal conspiracy theory is easily disposed of. It is uncontested that currently[7] GM's only formal presence at the automobile and light truck dealership level (and consequently at the crash parts installation and retailing level) is through its Motors Holding Division (MHD). (IDF 87)

Since 1929 the MHD has administered a Dealer Investment Plan under which it provides interim capital financing for a small number of new dealerships. Under this plan the prospective dealer is required to make an initial investment of at least 25% of the total required capital by purchase of non-voting stock in a dealership company. MHD provides the balance by purchase of voting stock and issuance of long-term notes. The dealer is paid a salary and shares equally in the dealership's profits on a per-share basis. The dealer conducts the day-to-day operations of the dealership. (IDF 91) While

[6] *See infra* note 91.

[7] In 1974 GM owned and operated a very small number (23) of automobile dealerships. (RAd. 763) These were phased out by 1976. (IDF 87) Historically, of course, none of the Big Three auto manufacturers has ever seriously attempted to utilize the agency form of distribution as a marketing device. *See generally* Schmitt, Antitrust and Distribution Problems in Tight Oligopolies: The Automobile Industry, 24 Hastings L.J. 849, 871 (1973); E. Cray, Chrome Colossus: General Motors and Its Times 30 (1980).

MHD owns all the voting stock in the dealerships which it finances, there is no evidence in the record that it uses its voting power to become actively involved in the daily management and direction of these corporations. *Cf. Chisholm Bros. Farm Equip. Co. v. International Harvestor Co.,* 498 F.2d 1137, 1142–1143 (9th Cir. 1974); *cert. denied,* 419 U.S. 1023 (1974); *United States v. Sealy, Inc.,* 388 U.S. 350, 353 (1967). Thus, as regards any given MHD dealership, GM functions as a financier rather than an operator. [12]

Moreover, under the Dealer Investment Plan the dealer has the right and is expected to increase his capital stock interest by purchasing the MHD-held stock. (IDF 91; CX 7029C–E) Between 1970 and 1977 the average length of MHD financing for a dealership was 5 to 6 years. (CX 34) Consequently, the MHD interest in any dealership is temporary.

Nor does the total number of dealerships operating under the Dealer Investment Plan change the nature or degree of GM's involvement with crash parts installation and retailing. There is not the slightest suggestion in the record that GM's crash parts policies were shaped by a desire to benefit the MHD dealerships, and it would be surprising if there were. Between 1929 and 1964 there were only 1,139 MHD dealerships. (IDF 91) The record shows that the MHD dealerships never accounted for more than 3% of the total GM dealerships between 1964 and 1977,[8] and that their number has declined since 1970.[9] There is also no evidence that the MHD dealerships conduct an abnormally large portion of the overall dealer bodyshop business. To the contrary: in 1977, MHD dealerships accounted for an estimated 4.3% of total GM dealer wholesale parts sales and an estimated 5.3% total GM dealer body shop sales. (RX 34; CX 38, 40)

In determining whether a business relationship is horizontal or vertical we must "seek the central substance of the situation, not its periphery." *United States v. Sealy, Inc.,* 388 U.S. 350, 353 (1967). In central substance, GM's relation to its dealers is that of franchisor and supplier; it is simply not sufficiently integrated forward to be classified as their competitor.[10] [13]

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[8] The ratio of MHD dealerships to total dealerships was, for 1964, 306:13,395 (2.3%); for 1974, 379:11,894 (3%); for 1977, 345:11,660 (3%). (RX 34; CX 38, 40, 2079C)

[9] MHD Dealer Equity Records and Financial Statements show 449 MHD dealerships in 1970, 379 in 1974, and 345 in 1977. (RX 34)

[10] On an apparently similar factual pattern, Ford's temporary ownership interest in an unspecified number of its franchised dealerships for financing purposes was held not sufficient to permit a finding that Ford had any significant share of the dealer-level market. *FLM Collision Parts, Inc. v. Ford Motor Co.,* 406 F. Supp. 224, 246 (S.D.N.Y.); *rev'd in part, aff'd in part,* 543 F.2d 1019, 1030 (2d Cir., 1976), *cert. denied,* 429 U.S. 1097 (1977).

(b) "Symbiotic" relationship

Complaint counsel also argue, albeit weakly, that GM has a meaningful presence at the wholesaling and installation level due to a "symbiotic relationship" with its dealers. This relationship amounts to nothing more than the general interest every supplier of consumer goods has in seeing that its products are ultimately sold to the public. To equate this community of interest to functional horizontality does total violence to the normally understood meanings of horizontal and vertical in the distributional context.

In conclusion, the ALJ correctly found that the essentially vertical relationship between GM and its dealers precludes a finding of horizontal conspiracy in this case. (IDF 373–375)

2. Vertical Theory

The scenario becomes much more complex under this approach. The issue is not the nature of the relationship between GM and its dealers—it is clearly vertical—but what in fact was their course of conduct and whether it amounts to a vertical boycott at law. Specifically, complaint counsel urge that GM seriously considered two different ways of opening its crash parts distribution system, but that each time dealer pressure, largely through the offices of their national trade association NADA,[11] forced GM to change its plans and keep the system closed to all but franchised dealers. Proof of these allegations is extremely delicate, since the denouement involves no clear-cut action by GM, but rather a continuation of its previous course of conduct as evidenced by what it did *not* offer the FTC in the shifting terms of [14]three GM settlement proposals[12] during the ongoing staff investigation which culminated in the issuance of this complaint. Also relevant are the terms of settlement urged by NADA as an interested third party, contemporaneously with GM's second settlement proposal. (CS 7327; ALJX 2)

The actions of GM and its dealers in the years preceding the 1975–1976 negotiations with the Commission staff are our only source from which to infer whether GM's settlement proposals were actually dictated by its dealers. Accordingly, that course of conduct

[11] As noted previously the National Automobile Dealers Association (NADA) represents about 70% of all GM dealers and is an intervenor on behalf of GM in this case. Its organizational structure and that of GM's dealer advisory bodies are described at IDFs 289–291. Throughout this section of the opinion "NADA" and "dealers" are used interchangeably.

[12] A word of explanation about the multiplicity of citations to a mere three settlement offers. Unfortunately, the jigsaw nature of this record reaches its apotheosis in the piecemeal admission of these proposals. The First Proposal (July 11, 1975) is found scattered throughout CX 7010, 7012, 7350; ALJX 11, 13C–D, 15. The Second Proposal (February 5, 1976) is found at CX 7012, 7350; ALJX 13B, 13H, 15. The ALJ rejected direct proof that GM made a third formal settlement proposal. However, the record does contain indirect proof of this offer, by means of testimony of both GM representatives and the Director of the Bureau of Competition before the Consumer Subcommittee of the Senate Committee on Commerce, on March 12, 1976. (RX 28J; ALJX 14, 17)

is chronicled at some length here, as a prologue to application of the relevant legal principles. For clarity's sake, even though the cast of characters and some events are the same, we give two histories: first, the line of events relating to a proposal to open GM's warehouses to IBS, which was offered in GM's first settlement proposal, withdrawn in its second, and indirectly reoffered in its third; second, the line of events relating to the more elusive "miniwarehouse plan" which was not offered to the FTC in any of the settlement proposals.

(a) Unsuccessful Settlement Proposals

The critical time period of this history is July 1975 - March 1976. It was during this time that the dealers became seriously concerned that GM might be planning to stop dealing crash parts exclusively to them and start selling directly to [15]their IBS competitors.[13] The dealers' fears were not unfounded. Almost since its inception in 1968 the Wholesale Compensation Plan was an obvious failure at creating crash parts price parity between dealers and IBS. (IDF 44) GM felt (rightly as it turned out) that unless it could remedy the situation in some other way the FTC was likely to challenge the distribution system as an unfair act under Section 5. (IDF 45) Accordingly, on July 11, 1975, GM submitted a three-point settlement proposal to the FTC (hereinafter the "First Proposal"). (CX 7010; ALJX 11) It offered

(1) To publish the suggested general trade (*i.e.,* wholesale) price on crash parts as defined by the FTC.[14]

(2) To include subcompacts and trucks in the Wholesale Compensation Plan (WCP), *provided* the FTC could either persuade or compel GM's competitors, including foreign competition, to do likewise.

(3) To sell to IBS and GM warehouses at dealer price.

NADA was given no advance warning of this proposal. (CX 7321; McCarthy Tr. 3560) Dealer reaction was instant and, as GM's counsel has stipulated, "vehemently" in opposition to Point 3, which came to be known as the "open warehouse" issue. (Tr. 3376) NADA

[13] Even before 1975 dealers were opposed to the possibility of changes in the crash parts distribution system, but any pre-1975 meetings seem to consist of general exchanges of view—nothing specific enough to mark the beginning of a coercive NADA compaign or a GM-NADA conspiracy. (McCarthy Tr. 3518; Pohanka Tr. 4690, 4769). Significantly, in these pre-1975 meetings GM expressed sympathy but would not commit to the dealers' position, carefully keeping open its options for change. "I know that on more than one occasion Mack Worden [GM's Vice President for Marketing] would say: This is how we feel about it now, but, of course, we can change our minds tomorrow. I remember that." (Pohanka Tr. 4698)

[14] This was to allow IBS to tell if a GM dealer was cheating on the WCP by marking up a part he was supposed to be selling at cost. (ALJX 2C)

organized to fight the proposal. (McCarthy Tr. 3564) During the next four months NADA continually urged [16]its views to the public,[15] to GM,[16] and to its members.[17] The members responded by sending "a considerable number of letters . . . to General Motors saying that they thought these actions served neither the dealers nor the consumers."[18] (Pohanka Tr. 4721)

Yet NADA had no confidence that all this activity was paying off. GM appears to have expressed sympathy for the dealers' position (CX 7305), but NADA was unsuccessful in getting a commitment to withdraw (McCarthy Tr. 3518, 3565–66) or even compromise (CX 7305) on the controversial proposal. Indeed, by early December 1975 the President of NADA's GM Line Group, Walter Stillman, believed that GM's position had actually hardened:

> They have already indicated a willingness to open the warehouses to independents at a Price as stated in their Proposal of July 1975.
>
> Thus it is not a question of will they open them, it is purely a question of at what Price, and it is for sure if the Dealers are to be the Sacrificial Lamb they will not hesitate long. (CX 7303C) [17]

NADA Executive Vice President McCarthy feared matters might get even worse, that GM might accept an FTC counterproposal to open its warehouses to IWs as well as IBS.[19] (McCarthy Tr. 3573–75). Accordingly, NADA started working on a new tactic: rather than rely on letters and phone calls to prod GM into recognizing the dealers' plight, it decided to represent dealers itself before the FTC, by means of a "4 Point Program" to be considered as an alternative to GM's still outstanding First Proposal. (McCarthy Tr. 3573–74) (CX 7303A)

The program was essentially worked out by December 17, 1975, (McCarthy Tr. 3526) when GM and NADA officials had the last meeting which is documented in this record. As will be seen, NADA's 4 Point Program submitted to the FTC on February 5, 1976, was

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[15] CX 7301 (July 25, 1975 NADA Press Release); CX 7354 (11/20/75 NADA letter to various Congressmen and Senators).

[16] "We were very distressed when General Motors made the offer. . . . And every opportunity I had to tell General Motors about that, I told them." (Pohanka Tr. 4718)

"I know all the [NADA] councils were fighting GM on it, or doing everything they could in recommending to them that they back off of it." (Vernon Tr. 3361)

CX 7319 (undated Mailgram, see Tr. 3363, 3373–74); CX 7303A; McCarthy Tr. 3563, 3564; CX 7305; Stillman Tr. 8177–78.

[17] CX 7314 (August 8, 1975 circulation to NADA members).

[18] CX 7310 may be an example of the type of letter that was written, although it was sent to the FTC, not GM. The record contains no examples of dealer letters to GM nor any better estimate of their number than Pohanka's testimony cited above. Thus it is impossible to evaluate the coercive tone or power of this phase of NADA's campaign.

[19] The record reflects that loss of their entire wholesaling business to IWs or the insurance companies was a far greater threat to dealers than the spectre of the IBS achieving price parity in crash parts. There is even some evidence that NADA felt it could live with opening warehouses to IBS (as opposed to IWs) if that were the outer bound of expanding GM's direct distribution system. (CX 7303E, I; McCarthy Tr. 3529–30)

essentially the same as GM's second proposed settlement offer (hereinafter "Second Proposal"), also submitted on February 5, 1976. Both eliminate the third point of GM's First Proposal: sales to IBS from GM's warehouses. Therefore, if any agreement took place between GM and NADA on the IBS question, it happened at the December 17, 1975, meeting.

NADA attendees who testified were Frank McCarthy, Executive Vice President and Kevin Tighe, Legislative Counsel, who, however, attended the meeting only briefly and sporadically. (Tighe Tr. 9505) Both also made notes of the meeting, which are in evidence as CX 7316 (McCarthy) and CX 7324 (Tighe). Also present were, for NADA: Jack Pohanka, President-Elect; Walter Stillman, Chairman of the Industrial Relations Committee's (IRC) GM Line Group; Paul Herzog, Director of Research and Dealership Operations; and Jay Ferrand, Assistant Director of Research; for GM, Michael Meehan, Executive in Charge of Service Parts Operation, and Jim Melican, attorney. (McCarthy Tr. 3519–20) The purpose of the meeting was to discuss the latest developments in the FTC investigation. (Tighe Tr. 9506) McCarthy, as might be expected, testified that while NADA representatives did tell GM what "we thought would be the proper approach to solve the crash parts program" (*i.e.,* the Four Points) they did not ask for GM's opinion of or concurrence in their proposed program. (McCarthy Tr. 3525–27, 3570–71) (*See generally* Pohanka Tr. 4768–69) [18]

Against these statements must be set one sentence from Tighe's notes: "What can GM and dealers do together to keep independent distributors out of crash parts area????" (CX 7324B) Tighe's explanation of the sentence, constantly repeated in his testimony without change, is that it was a paraphrase of what Melican reported as being the FTC's concern at that time. In other words, Tighe thought he was told that the FTC was thinking of issuing a complaint which included a conspiracy count.

> [A]ccording to Mr. Melican, as far as crystal ball gazing, if you will, FTC would probably come forth with some form of a complaint which would involve the issue of GM, its dealers, doing something in the area of conspiring to keep independents out. That is why the asterisk is at the top[20] and it reflects FTC has never answered, and then it picks up later on with Melican's, as I stated, analysis and his opinion of what would perhaps be forthcoming at a later date from the FTC. (Tighe Tr. 9518; *see also* Tr. 9509–10, 9520–21)

McCarthy stated flatly that this portion of Tighe's notes is inaccurate. (Tr. 3522)

[20] This is a reference to the position of the key sentence on the document, from which both parties attempted to infer special meaning.

Despite Tighe's uncooperative conduct as a witness we are inclined to accept his explanation for the following reasons. The sentence does appear in the context of a summary of the FTC's position. Tighe's area of expertise was "work on Capitol Hill"; he was unfamiliar with the FTC crash parts matter which was handled by outside counsel. (Tighe Tr. 9507) That, plus his sporadic attendance of the meeting, could explain his misunderstanding Melican.

The record is silent with regard to any actions by either NADA or GM after December 17, 1975, until February 5, 1976, when each sent a separate settlement proposal to the FTC.[21] The proposals were later described by NADA official Cecil Vernon as "essentially the same."(CX 7353B; Vernon Tr. 3389–90) Both advocated improving crash parts distribution by increasing the dealers' opportunities under the WCP: [19]

NADA Proposal	GM Proposal
1. Increase WCP to 30 % (CX 7327E)[22]	1. GM states that it has already raised WCP to 30% in October, 1975. (ALJX 13G)
2. Publish wholesale prices of crash parts (CX 7327F)[23]	2. GM will publish wholesale prices of crash parts (ALJX 13A-B)[23]
3. Require GM to offer WCP on all models, including subcompacts and compacts (CX 7327G; ALJX 2D)[24]	3. GM will make WCP available on subcompacts and lightduty trucks on a trial basis, with the option of withdrawing at the end of six months if principal competitors, including the foreign competition, fail to implement a similar plan. (ALJX 13I)[24]

[21] The record does not reveal the reasons behind GM's timing of the Second Proposal. It does show that NADA perceived growing FTC pressure on GM in the new year, and so made haste to file its proposal before it was too late. (McCarthy Tr. 3574–75; CX 7324B) This does not, of course, explain the fact of contemporaneous filing.

[22] NADA realized that GM had already taken this step (ALJX 2C) but apparently felt that it needed to be ratified by the FTC. The increase to 30% was supposed to take away the pressure to overcharge to IBS, due to inadequate wholesale compensation. (ALJX 2C)

[23] This provision also appeared in GM's First Proposal.

[24] This is a slight variation on the second point in GM's First Proposal.

NADA Proposal	GM Proposal
4. Require GM to offer the WCP across division lines. (CX 7327F)[25]	4. GM will pay wholesale compensation across division lines, for sales to IBS.[25] (ALJX 13G) [20]

It is obvious that the key differences between GM's First Proposal and these two proposals are the absence of the provision on direct sales by GM to IBS and the appearance of the provision on extending WCP to cross division lines sales. Both February proposals make it clear that broadened WCP is an alternative which negates the need for direct sales to IBS.

[I]n lieu of opening up the 27 General Motors Parts Division's field warehouses for direct sales to the independent auto body repair shops, General Motors would be willing to agree to broaden the Wholesaling Compensation Plan. . . . (ALJX 13G) (emphasis in original)

[O]pening the manufacturers' warehouses . . . is also a prime example of governmental overkill. Any dealer overpricing can be simply and effectively by-passed by adoption of points 1 and 2 of NADA's proposal. (ALJX 2D)

The convergence of timing and content in these two February proposals is certainly remarkable, but before considering whether it shows a conspiracy, we must consider GM's action just a month later.

On March 1, 8, and 12, 1976, the Consumer Subcommittee of the Senate Commerce Committee held hearings on the cost of automobile crash parts.[26] In his testimony on March 1, 1976, the Director of the Bureau of Competition described the First and Second Proposals, suggesting that the change on the sales to IBS provision was the result of successful dealer pressure on GM. (ALJX 17, Johnson p. 8) In response, by letter of March 5, 1976, to the Director of the Bureau of Competition (CX 7013, *rejected*[27]) and by the March 12, 1976, testimony of [21]Michael Meehan, General Motors added a fourth element to the Second Proposal:

Last week, we added a fourth element to our proposal.

[25] The WCP did not and still does not offer rebates on resales of crash parts used on a brand of automobile which the dealer is not franchised to sell. Thus, under this proposal a Pontiac dealer, who previously received wholesale compensation solely for resale of Pontiac crash parts, would be eligible for wholesale compensation on the sale of Chevrolet, Oldsmobile, Buick and Cadillac crash parts as well.

[26] The complete transcript of the hearings is entered in the record as ALJX 17; portions of the testimony from the hearings are also available as RX 28, ALJX 14.

[27] CX 7013 is the letter of March 5, 1976, from GM's General Counsel to Owen Johnson, Director of the Bureau of Competition. Complaint Counsel sought to introduce it, post trial, in response to respondent's proposed reply findings. By order of September 6, 1979, the ALJ rejected CX 7013 as being "unnecessary" to his decision. We disagree. Though not vital, it is certainly helpful to an evaluation of GM's continuing interaction with NADA. Meehan's March 12, 1976, testimony does not have the weight of the actual formal offer itself. Accordingly we have included CX 7013 in the record.

Fourth: If an independent body shop is unable to buy crash parts from any one of the GM dealers in its vicinity at the dealer price, GM would agree to sell these parts to the independent dealer at dealer net price directly from its field warehouse. (ALJX 17, Meehan testimony p. 122)

This "safety valve" approach to IBS buying from GM warehouses is very close to GM's First Proposal.[28]

Although it is too late to test the degree of good faith lying behind this Third Proposal (and it smacks not a little of a last minute grandstand ploy), nevertheless it does show that GM could slip out from under NADA's thumb whenever its purposes suited it.

(b) The Miniwarehouse Plan

Complaint counsel argue that at least one of GM's settlement proposals should have contained an offer to restructure the crash parts distribution system by adoption of a "miniwarehouse plan." They argue that GM had such a plan on the drawing board, perhaps even in limited test operation, but aborted the program, at dealer insistence. (CAB 36) [22]

The first problem with this theory is that there is no definitive explanation of the "miniwarehouse plan" in the record. Three dealer witnesses (none of whom was ever a GM employee) testified as to their general understanding of its elements. (Stillman Tr. 8060, 8071–72; Pohanka Tr. 4692, 4695–96; McCarthy Tr. 3490–91) From their often conflicting accounts it appears that the "plan" envisioned General Motors Parts Division (GMPD) setting up franchises for the purpose of wholesaling crash parts. The franchisees could be, but were not limited to, GM dealers. The miniwarehouses were to supplement, not replace, GMPD's then twenty-seven (possibly thirty-six) parts warehouses. It represented a limited opening up of the crash parts distribution system at the warehouse level.

The record, which is extremely skimpy on the whole issue,[29] shows that this "plan" was never significantly operational and although GM management may have been dimly aware of the concept, it did not endorse miniwarehousing in either theory or fact; dealers, to the extent they were even aware of the plan, considered it

[28] In the Second Proposal GM stated that its first offer to sell to IBS had been intended to apply "only in those instances in which the independent operator was unable to negotiate what he considered to be a fair price. . . . [T]he warehouses would constitute an alternative source, a safety valve. . . ." (ALJX 13D) However, the First Proposal, both as presented to the FTC and as described to dealers by GM, nowhere makes such a limitation. (ALJX 11G, CX 7010E, ALJX 16A, CX 7321)

[29] Complaint counsel's testimonial case rests entirely on four hostile witnesses, each a GM dealer or NADA official during the time of events they testified to. Having dared this much, their failure to call GMPD's General Manager Lewis Kalush—an equally hostile witness, but one infinitely more knowledgeable on the subject—weakens an already weak case. With no reliable documents showing that the miniwarehouse plan had any official status at GM, we are forced to rely upon the testimony of these dealers, despite its obvious self-serving nature.

no threat, and forbore from lobbying GM concerning it. There is simply no boycott case arising out of the miniwarehouse scenario.

The origins of the miniwarehouse program are obscure. Complaint counsel root it in the early 1970's, by virtue of an experimental dealer warehousing program in Phoenix, Arizona. (CPF 285)[30] However, the record contains only the barest [23]rumor about this experiment as the only witness called to testify about it had no personal knowledge on the subject. He could give no details about Phoenix set-up, dates of operation (even to the nearest year) or success, if any. (Stillman Tr. 8070–72, 8142) Even allowing for the witness' bias towards GM[31] we cannot see in his testimony the picture which complaint counsel paints of a viable, operational miniwarehouse program.

Dealers first became systemically aware of miniwarehousing in the second half of 1974, when the idea was floated before them by Lewis Kalush, General Manager of GMPD, an office which does not carry the authority to change GM's distribution system. (Meehan Tr. 2227–29) Four witnesses either attended or heard of a meeting or meetings[32] where the concept was discussed. However these meetings were not called solely or even chiefly to discuss miniwarehousing. GMPD was then in its second year as a separate division of GM. (IDF 162) The witnesses characterized the gathering(s) as get-acquainted sessions organized by Kalush to air dealer complaints about the GMPD distribution system and discuss generally alternatives for improvement. (Faulkner Tr. 11803–11804)

Significantly, the miniwarehouse alternative was not presented as a firm plan.

> This was a concept that they had. They weren't saying whether they [were] going to establish it or not. This was a concept, a discussion that was going on about parts distribution. (Stillman Tr. 8068–69) [24]

The dealers perceived it as a pet project of Lewis Kalush, lacking in support from GM management[33] and of no threat to their exclusive

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[30] Complaint counsel also rely on CX 7217, a document which from internal evidence was written between 1972 and 1975, to give the miniwarehouse program historical authority. However, the document appears to be the product of GM's Service Section (CX 7217A), a GM unit which has nothing to do with the distribution, warehousing or selling of GMCP. (Meehan Tr. 2191, 2225) No witness was called to identify the author of the document or show that program advanced in CX 7217 was either considered or adopted by GM management.

[31] Walter Stillman, a Buick dealer, was a former chairman of the GM Line Group of NADA's Industrial Relations Committee.

[32] It is unclear whether each witness refers to the same meeting, or whether some are recalling different ones of a series of meetings. Witness Stillman implies the latter (Tr. 8068), but his testimony is the only support for complaint counsel's assertion that the miniwarehouse plan was proposed several times to groups of dealers between mid-1974 and early 1975. (CPF 286; CAB 36)

[33] There is some conflict over whether GM—as opposed to GMPD—officers attended the(se) first miniwarehouse meeting(s). Witness Faulkner recalls GM president Cole being at the August, 1974 meeting (Tr. 11792); the three other witnesses mentioned only GMPD officers, most notably Kalush. (Stillman Tr. 8071; Pohanka Tr. 4692; McCarthy Tr. 3490–91)

wholesaling rights in crash parts. This was made abundantly clear by NADA officials' reaction to an unexpected pitch for miniwarehousing by Kalush at a meeting with select NADA officials on April 2, 1975.[34] The meeting was intended to be a briefing on the FTC investigation, but Kalush saw an opportunity to promote his project. As Frank McCarthy,[35] Executive Vice President of NADA recalled:

> It was my reasonably clear recollection that even at the outset—but it became clear, because of the nature of the discussion—that the comments of Mr. Kalush were his comments as an individual, and did not reflect the opinion of even other members of the GM parts division. (Tr. 3581)
>
> * * * * * * *
>
> [25]I mean, it was just very clear that Mr. Kalush, because of the parts distribution system, the way it is in General Motors, wanted the mini-warehouse concept, dealer stocking concept, implemented, because that would come under the General Motors [P]arts [D]ivision and it would come under him. And as part of selling that idea to dealers, this is my clear impression, that he was trying to sell dealers on the mini-warehouse proposal as a solution to the crash parts problems. (Tr. 3582)

Complaint counsel assert, without any citations to the record, that the April 2, 1975, meeting crystalized NADA's opposition to the miniwarehouse plan. However, McCarthy's testimony shows neither a hostile nor defensive dealer reacton to Kalush's plan. Though the consensus was that more dealers would be made unhappy than happy by the plan (McCarthy Tr. 3492), NADA never considered the program a real enough threat to warrant polling its membership for reactions. (McCarthy Tr. 3495) Again, allowance must be made for the witness' obvious bias in favor of respondent, but the record does not contain any testimony or documents[36] which refute Mr. McCarthy. [26]

The final time of significance in this history is May 1975. GM's

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[34] The 1974 meeting(s) do not seem to have involved any dealers holding office in NADA. (Faulkner Tr. 11798–99) By contrast, the April 2, 1975, meeting was initiated and attended only by NADA officers: Jack Pohanka, President of the Industry Relations Committee; George Erwin, possibly Chairman of the Service and Parts Committee; Walter Stillman, Chairman of the GM Line Group; Paul Herzog, Director of Research and Dealer Operations; and Frank McCarthy, Executive Vice President of NADA. Representing GM were Lewis Kalush and Jim Melican, Attorney in Charge of Trade Regulation. (McCarthy, Tr. 3486, 3580–81)

[35] Neither Stillman nor Faulkner testified to this meeting; Pohanka recalled it only in the most general outline. (Pohanka, Tr. 4696–97) Thus McCarthy's testimony is the only detailed data in the record on this subject.

[36] Complaint counsel's sole support for the statement that the day after April 2, 1975, NADA officials held a meeting to oppose the miniwarehouse program is CX 7346A–F. We can only surmise that the document was admitted in order to give use the pleasure of reacquainting ourselves with that bane of law school evidence examinations, of triple hearsay. The document consists of handwritten notes of Lee Beaudry, a member of the NADA Parts Committee, which happened to be meeting in NADA headquarters on April 3, 1975, in order to revise the parts operations manual. (Beaudry Tr. 2750) If Beaudry's notes are to be believed, Pohanka stopped by and told the Committee what Kalush and Melican had told the five NADA executives the day before. Neither Beaudry nor Pohanka has any independent recollection of the April 3, 1975, meeting.

To admit these notes for the truth of what Pohanka stated was NADA's position, or, still worse, what was GM's position with regard to any subject goes beyond even the wide latitude accorded hearsay under the Commission's Rule of Practice Section 43(b).

Moreover, even if the document has any evidentiary weight it does not prove what complaint counsel state.

(Continued)

President Estes and four other officials (none from GMPD) met with NADA's President of the Industrial Relations Committee, Pohanka, and Chairman of the GM Line Group, Stillman, to discuss "several items that GM dealers were interested in." (Pohanka Tr. 4691) Complaint counsel claim a major purpose of the meeting was for NADA to outline its objections to the miniwarehouse plan. However it is clear that many other topics were to be covered at that meeting. (Stillman Tr. 8143–44) Moreover, although as we have noted NADA was opposed to a totally open crash parts distribution system, it had not yet taken a position against the less sweeping mini-warehouse proposal. (Stillman Tr. 8145)

Nevertheless one of fourteen items on the pre-meeting agenda presented to Estes was "Mini Warehouses". (CX 7205C) The record does not indicate whether Estes had knowledge in detail of the subject,[37] but he managed to convince the NADA officials of his disinterest:

I remember using the word "mini-warehouse," and was surprised that Mr. Estes said, "what's a miniwarehouse?"
We had to tell him.

* * * * * * *

Q. You mentioned that Mr. Estes was unaware of that term. After you informed him of the term, was there a discussion of miniwarehouses?

A. As I recall, it was a completely new idea to him. I didn't see any point in pursuing it any further.

Q. So you just laid it on the table and left?

A. As I recall. (Pohanka Tr. 4694, 4698) [27]

After this date the record is silent on dealer opposition to the mini-warehouse program.

Given this history, it is hardly surprising that GM's July 11, 1975, settlement proposal to the FTC made no mention of the mini-warehouse plan. At its strongest the plan appears merely to have been the pet project of a division head, who sought dealer aid in promoting it to GM management as he was powerless to implement it without endorsement by GM's executive committee. (Meehan Tr. 2227–29) To the extent that the plan was tried out in Phoenix, it was dropped for causes other than dealer pressure. The record does not

Rather, it confirms that the mini-warehouse plan was perceived as Kalush's alone (CX 7346B), that some dealers liked the idea (CX 7346C) and is silent on the matter of NADA opposition to mini-warehousing.

[37] The single line on CX 7205C listing "Mini Warehouse" as a topic of discussion is the only documentary proof linking the plan with upper echelon GM management. The document was entered in the record without benefit of explanatory testimony from either its author, GM Vice President Worden or its recipient, GM President Estes. The document on its face is merely a list of topics NADA wished to discuss; it does not indicate that GM management had any independent information on these topics. Thus even if GM President Cole attended a meeting where mini-warehousing was discussed in 1974 (see n. 33, *supra*) is entirely possible that official awareness of the concept did not carry over to President Estes' administration.

show that the mini-warehouse plan was either operational on July 11, 1975, or being seriously considered by GM at that time. Nor does the record show that NADA launched any specific lobbying effort against the mini-warehouse proposal.

(c) Legal Analysis

Whether known as boycotts or concerted refusals to deal,[38] collective efforts to exclude a party from the marketplace are illegal *per se* under Section 1 of the Sherman Act. *Northern* [28]*Pacific Ry. Co. v. United States,* 356 U.S. 1 (1958); *Klors, Inc. v. Broadway-Hale Stores,* 359 U.S. 207 (1959). Even the Supreme Court, however, has recently acknowledged that the decisions on what constitutes necessary elements of a boycott in violation of the Sherman Act "reflect a marked lack of uniformity in defining the term." *St. Paul Fire & Marine Ins. Co. v. Barry,* 438 U.S. 531, 543 (1978). Although the finding of a boycott or concerted refusal to deal invariably turns on the facts in the cases, no conclusive fact-pattern has emerged which spells out precisely what a boycott is. As a consequence the cases in this area are often confused. Grouping them under the categories of primary and secondary boycott[39] provides an analytical framework which helps to identify useful precedent for the matter at hand.

The first type of case deals with a "primary" boycott, where a number of economic actors at one level of the productive or distributive process either discontinue economic relations with an actor or actors at another level, or predicate continuance of economic relations only on certain terms. *Paramount Famous Lasky Corp. v. United States,* 282 U.S. 30 (1930). A distinguishing feature of a primary boycott is that the resultant economic harm is suffered by businesses which are not competitors of the members of the combination. The case before us is not a primary boycott situation,

[38] Scholars of this issue have debated whether the draconian foreclosure of inquiry which is the hallmark of *per se* analysis should be applied to every concerted refusal to deal. In particular, their concern is that market effects and specific purpose should be weighed when the group exercising concerted power is noncommercial; or when the main purpose and effect of the boycott are not protection of the conspirators' profits. *See, e.g.,* Bird, Sherman Act Limitations on Noncommercial Concerted Refusals to Deal, 1970 Duke L.J. 247; Barber, Refusals to Deal Under the Antitrust Laws 103 U. Pa. L. Rev. 847 (1955); L. Sullivan, Handbook of the Law of Antitrust 256–259 (1977). To clarify when the use of *per se* analysis is appropriate, some commentators have proposed mutually exclusive definitions of the terms "boycott"and "concerted refusal to deal". Sullivan, *supra,* 258; Note, Boycott: A Specific Definition Limits the Applicablity of the Per Se Rule, 71 Northwestern U. L. Rev. 818 (1977). However, the case before us alleges a classic exercise of concerted power by traders at one level of the distribution process to protect themselves from competition or potential competition at that level. Therefore, we will use the terms "boycott" and "concerted refusal to deal" interchangeably; we express no opinion as to the merit of any of the limiting definitions.

[39] The terms are derived from Bird, Sherman Act Limitations on Noncommercial Refusals to Deal, 1970 Duke L.J. 247 (1970). Professor Bird also describes a third variety of concerted refusals to deal where a group establishes a joint facility or a trade association and limits access to it. This situation is far removed from the case before us and therefore need not be considered here.

since GM and its dealers do not occupy the same level of the productive process, and the victim group (IBS) is competitive with some of the members (dealers) of the alleged combination.

In a secondary boycott, a group threatens an economic actor or actors at another level of the productive or distributive process to force them to refuse to deal with someone else—usually a competitor of the boycotting group. A distinguishing feature of a secondary boycott is that the resultant economic harm is directly caused by a conscripted neutral, not the boycotters. **[29]**

Secondary boycotts may be further divided into two subgroups, depending upon whether the coerced neutral stands above or below the boycotters in the distribution chain. *United States v. Parke, Davis and Co.,* 362 U.S. 29 (1960), is an example of a Sherman Act Section 1 violation found in coercion flowing down the distribution chain. There a pharmaceutical company refused to deal with wholesalers in order to elicit their willingness to deny its products to retailers and thereby help force the retailers' adherence to its suggested minimum retail prices. Such cases are not analogous to our situation, where the alleged pressure rose from the distributor level to the manufacturer.

We must look, then, for precedent in cases dealing with pressure by entities at a lower level of the distribution chain upon their supplier.

Turning to such cases, we find none where coercion was found solely on the basis of such a blustering, but ultimately toothless course of conduct as the GM dealers engaged in during 1974–1976. NADA never once (on this record at least) threatened GM with the one sanction which would be significant to it: loss of new car sales. *Cf. U.S. v. General Motors,* 384 U.S. 127 (1966). As the ALJ noted, our situation is a long way from the naked wielding of buying power in *Hershey Chocolate Corp.,* 28 F.T.C. 1057 (1939), *aff'd,* 121 F.2d 968 (3rd Cir. 1941).

However, complaint counsel are also correct when they argue that direct proof of the wielding of such power is not a necessary element of a violation of Section 1 of the Sherman Act. (CAB 37) There have indeed been cases where a response to "mere complaints" was held to be an act under compulsion. What complaint counsel miss, however, is the fact that in these cases the courts, finding the complaint did not constitute an obvious threat, inferred the existence of the iron hand inside the velvet glove from the fact that the target suddenly and completely capitulated to the boycotter's will. These cases also indicate that the more irrational the changed

business pattern, from the viewpoint of the target, the more suspect is its motivation.

In this matter, GM never committed itself to do what the dealers wished. GM's constant brush-off of its dealers' complaints contrasts sharply with the situation in *Ford Motor Co. v. Webster Auto Sales,* 361 F.2d 874, 877 (1st Cir. 1966), where, in response [**30**]to a dealer's complaints, Ford sent letters to its dealers requesting them not to bid on "company cars" for the purpose of wholesaling them. Another contrast may be found in *Bowen v. New York News Inc.,* 522 F.2d 1242 (2d Cir. 1975), *cert. denied,* 425 U.S. 936 (1976), where, in response to franchise dealer complaints the newspaper publisher harassed and terminated supply of its papers to franchisees who sold those papers to independent dealers in competition with the franchised dealers; and in *U.S. v. General Motors Corp.,* 384 U.S. 127 (1966), where within two months of receiving complaints about dealers who had business dealings with discounters, GM elicited from each such dealer a promise to discontinue the practice, and set up a system to police compliance with the agreements.

Complaint counsel argue hotly, and with some logic, that since what the dealers requested of GM was inaction, compliance with dealer "requests" cannot possibly be shown by any affirmative response—all GM had to do to acquiesce was follow the course it had been following already and keep its crash parts distribution system closed to all but franchised dealers. However, this argument infers too much. Even in cases where direct action is taken by the supplier, and such action is precisely what is requested by complaining distributors, the inference of concerted action, "a conscious commitment to a common scheme," is not made automatically. *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.,* 637 F.2d 105 (3rd Cir. 1980), *cert. denied,* 451 U.S. 911 (1981). In *Sweeney,* the defendant gasoline supplier could show that it had its own reasons for terminating a dealer, and did not object to his pricecutting practices which had caused competing Texaco retailers to complain. Consequently, there was no concerted action, even though the result was the same as if the threat had been heeded.

When no change to a pattern of business conduct is the gravaman of the complaint, it is particularly difficult to overcome the inference that the manufacturer's choice not to move is based on those same unilateral business reasons which led it to adopt the system in the first place.[40] Thus, in *Aviation Specialties Inc. v. United Technolo-*

[40] A manufacturer's good faith choice of a distribution system may still be an arbitrary one. A later section of this opinion discusses the objective reasonableness of GM's commitment to a selective distribution system for crash parts; at this time, however, we are concerned only with divining whether that decision was unilateral or not.

gies Corp., 568 F.2d 1186 (5th Cir. 1978) a would-be distributor of repair parts for the Pratt-Whitney P–T6 [31]airplane turbine engine challenged Pratt-Witney's refusal to deal with him as a violation of Section 1 of the Sherman Act. In affirming summary judgment for the defendants, in part because plaintiff failed to prove a conspiracy between Pratt-Witney and its distributors, the court stressed:

> ASI bears a particularly heavy burden because Pratt-Witney set up its distribution system in 1964, long before ASI began operations, and the structure of the system has not changed perceptibly since its inception. 568 F.2d at 1192.

In *Aviation Specialities,* the plaintiff had absolutely no evidence of dealer pressure on the supplier to keep the distribution system closed, whereas in this case we have a history of dealer efforts to influence the supplier. Nonetheless, the burden of showing collusive conduct is still particularly heavy when the challenged action is a decision to maintain a long-established distribution system.

(d) Conclusion

Here, by looking at the total course of conduct rather than merely the final moment, we are persuaded that GM acted in its own self-interest, rather than at dealer behest. The Tighe notes and similarity of the February proposals raise a question of conspiracy. But against these must be set the entire pattern of conduct between GM and NADA during 1975 through March 1976. That pattern reveals that GM, like any manufacturer, preferred to have its dealers' good will. Accordingly, when it cost GM nothing to placate the dealers it did so: giving general expressions of sympathy during various 1975 meetings and changing the First Proposal after the FTC showed no sign of accepting it. On the other hand, GM was quite ready to ignore the dealers when there was advantage in doing so. Hence, the First and Third Proposals offered without consulting the dealers; the constant refusal, during those 1975 meetings, by GM to commit itself to any hard and fast position. Moreover, NADA, in our opinion, read the pattern the same way. Throughout 1975 dealers were in uncertainty and despair over GM's intentions towards them. They did not threaten GM with economic reprisals. Instead they argued and pled and tried to enlist allies in Congress and the FTC. These are not the actions of successful boycotters. [32]

B. Abuse of Monopoly Power Through Leveraging

Complaint counsel advance several theories under which GM's distribution system is an abuse of monopoly power. Two of these theories, "leveraging" monopoly power and "extension" of monopoly

power, are virtually identical and not applicable to this case due to the same fact which caused the horizontal boycott theory to founder: GM's minuscule presence in the dealership level of the crash parts distribution chain.

The courts have long held that it is an abuse of monopoly power for a monopolist to use its monopoly power in one market to extend or leverage that power into another market. *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973); *United States v. Griffith,* 334 U.S. 100 (1948); *Berkey Photo Inc. v. Eastman Kodak Co.,* 603 F.2d 263 (2d Cir. 1979), *cert. denied,* 444 U.S. 1093 (1980); *Sargent-Welch Scientific Co. v. Ventron Corp.,* 567 F.2d 701 (7th Cir. 1977), *cert. denied,* 439 U.S. 822 (1978); *United States v. Aluminum Co. of America,* 148 F.2d 416 (2d Cir. 1945); *United States v. Klearflax Linen Looms, Inc.,* 63 F. Supp. 32 (D. Minn. 1945). However, the majority of these cases arose from situations which suported a finding of attempt to monopolize as well as abuse of monopoly power by leveraging activities. They therefore have limited guidance to analysis of the facts in this case, where attempt to monopolize was never an element of the case and cannot be proven. Two closely intertwined requisites for an attempted offense are totally lacking: (1) specific intent to control prices or destroy competition, *United States v. Aluminum Co. of America,* 148 F.2d 416 (2d Cir. 1945), and (2) dangerous probability of success, *United States v. Swift & Co.,* 196 U.S. 375 (1905). To illustrate this we need do no more than refer to facts already summarized concerning GM's historical presence at the dealership level through its MHD financial arrangements.

As noted, General Motors' only presence at the retail and installation level of crash parts distribution is its financial interest in the MHD dealerships. Even assuming this financial interest amounted to functional control, a market presence which [33]has not risen above 3% in 13 years does not remotely suggest that GM is moving progressively closer to monopoly power at the dealership level. [41]

On the question of intent, again we note that the record is devoid of evidence that General Motors' crash parts distribution policies are

[41] By contrast, in *Otter Tail,* the defendant wholesaler of electrical power had achieved a 91% share of the leveraged market for retail power. 410 U.S. at 370. In *Griffith* the dangerous probability standard was not specifically discussed, as the case was remanded for proof of effects. However, the court noted that defendant film exhibitors had increased their share of single-theatre towns from 51% to 62% over a five year period. 334 U.S. at 102. It was during this period that defendants exercised their pooled buying power to ensure that members of the circuit got exclusive rights to first run films, to the detriment of their competitors. *Id.* at 104. Finally, in *Alcoa,* the defendant used its monopoly power in aluminum ingot to impose a price squeeze on purchasers which competed with it in the manufacture of aluminum sheet; by this means Alcoa, already the largest maker of aluminum sheet, eliminated half the companies competing with it in that market. 148 F.2d at 436.

established or maintained in order to benefit the MHD dealerships.[42] Nor is the mere choice of a selective distribution system, even by a manufacturer who is also a distributor, in itself the sort of invidious conduct which supports an inference of intent to prevail over competitors by improper means[43] [34]

Nevertheless we must still determine if General Motors' conduct fits within that line of cases which holds that leveraging monopoly power can violate the antitrust laws even when it does not amount to an attempt to monopolize. Complaint counsel rely heavily upon *Berkey Photo Inc. v. Eastman Kodak Co.,* 603 F.2d 263 (2d Cir. 1979), *cert. denied,* 444 U.S. 1093 (1980) and *Sargent-Welch Scientific Co. v. Ventron Corp.,* 567 F.2d 701 (7th Cir. 1977), *cert. denied,* 439 U.S. 822 (1978).

Both cases differ from this one in terms of mode, impact and especially purpose of the leverage. In the matter of mode the difference is least and the analogy strongest. While neither *Berkey* nor *Sargent-Welch* involved a refusal to deal, each did concern a mode of leverage which was not pernicious on its face, but instead could have been a reasonable business act. In *Berkey,* defendant Kodak introduced new products; in *Sargent-Welch* a manufacturer terminated a dealer, ostensibly because of the dealer's failure to represent the manufacturer adequately.

In neither *Berkey* or *Sargent-Welch* did the monopolist have as small a share of the leveraged market as GM does in the crash parts installation (dealer bodyshop) market. Moreover, in both cases the leverage affected a new segment of a market, such that the resultant distortion in favor of defendant might be expected to grow. By contrast, GM's share of the bodyshop market has remained static for a long time. Thus impact on competition was potentially[44] more severe in *Berkey* and *Sargent-Welch* than here.

This fact is closely allied to the purpose element of these cases. Although the specific attempt to monopolize standard has been diluted to a general intent to gain a competitive advantage in the downstream market, even this lesser intent cannot be found in General Motors' choice of a distribution system. It would be an

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[42] By contrast, in *Klearflax* the defendant rug manufacturer and distributor took several clearly predatory steps such as refusing to fill orders for a rival distributor, Floor Products, after learning that Floor Products had underbid it for a government contract, and asking its distributors not to undercut it by selling to Floor Products. Moreover, Klearflax's General Manager specifically announced "My plan is definitely to squeeze Floor Products out of this government business . . . ." 63 F. Supp. at 36.

[43] As we noted in *E.I. DuPont de Nemours & Co.,* 96 F.T.C. 653 (1980), the degree of market power which indicates a dangerous probability of success may vary with the nature of the challenged conduct. *Id.* at 725 n.16. Here, however, GM's choice of a selective distribution system is so innocuous in nature that the question of applying the sliding scale does not arise.

[44] It was never actually measured in either *Berkey* or *Sargent-Welch*—both cases were remanded for further findings on exactly this issue and settled out of court before findings could be taken.

example of the tail wagging the dog to infer that GM chose to distribute crash parts selectively in order to protect its MHD dealerships' bodyshops from the competition of the IBS. **[35]**

C. Abuse of Monopoly Power Through Refusal To Deal

1. Legal Analysis

Complaint counsel are on firm ground at last when they turn to the line of cases which concern abuse of monopoly power over a scarce resource which other firms are under a commercial compulsion to use. *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973); *Silver v. New York Stock Exchange,* 373 U.S. 341 (1963); *Associated Press v. United States,* 326 U.S. 1 (1945); *United States v. Terminal R.R. Assn.,* 224 U.S. 383 (1912); *Fulton v. Hecht,* 580 F.2d 1243 (5th Cir. 1978); *Hecht v. Pro-Football, Inc.,* 570 F.2d 982 (D.C. Cir. 1977), *cert. denied,* 436 U.S. 956 (1978); *Gamco Inc. v. Providence Fruit & Product Bldg.,* 194 F.2d 484 (1st Cir. 1952), *cert. denied,* 334 U.S. 817 (1952); *Lake Carriers Assn. v. United States,* 399 F. Supp. 386 (N.D. Ohio 1975); *Grand Caillou Packing Co.,* 65 F.T.C. 799, *aff'd sub nom. La Peyre v. FTC,* 366 F.2d 117 (5th Cir. 1966).[45] In each of these cases monopolistic control over a unique or essential product or facility caused significant competitive harm when coupled with a refusal to deal with a portion of that class of persons who were under a commercial compulsion to use the product. In other words, the monopolist's refusal to deal was judged illegal because it created a "haves" vs. "have nots" situation in the downstream market.

In some of the cases the monopolist itself, in its secondary distribution function, was in the downstream "haves" group, and so benefited from the selective refusal to deal. Thus, some of these cases appear to fit under the rubric of "leverage" where, as we have seen, an abuse of monopoly power is found when the facts show that the monopolist intended to bolster its downstream market position by use of its upstream monopoly power. However, the rationale of these "essential product cases" goes beyond that **[36]**of the leverage cases. In essential product cases the abuse of monopoly power lies in the failure to make a scarce resource available to all potential users on nondiscriminatory terms, not merely in any incidental benefit to the monopolist's position in the secondary or downstream market. The courts' focus in such cases has been on the unlawful harm to

[45] Also part of this line of cases is the Commission's decision in *The Reuben H. Donnelley Corp.,* 95 F.T.C. 1, *rev'd sub nom. Federal Trade Commission v. Official Airline Guides, Inc.,* 630 F.2d 920 (2d Cir. 1980), *cert. denied,* 101 S. Ct. 1362 (1981). The Commission's position is that the Second Circuit's reversal of *Donnelley* was erroneous. Nevertheless, we do not rely upon the *Donnelley* decision in this case; but until and unless it is repudiated by the Supreme Court we hold to our interpretation of the case law on arbitrary refusals to deal by monopolists, which has been espoused by the Fifth Circuit in *La Peyre, supra.*

competition, not the gain to the monopolist. Similarly, the fact that in some of the cases the competitive injury was caused by a joint refusal to deal does not weaken their precedential value to this case. It has long been established that "the existence of a combination" is not an "indispensible ingredient" of an unfair method of competition under Section 5 of the FTC Act. *FTC v. Cement Institute,* 333 U.S. 683 (1948). The Commission, proceeding under Section 5, may properly draw upon the policies expressed in the Sherman Act's prohibition of joint refusals to deal. Those policies mirror the concerns of the scarce resources cases: monopolistic power should not be used to discriminate among competitors in an adjacent market, if that discrimination is arbitrary and causes substantial competitive injury. Again, the emphasis is primarily upon the competitive dislocations caused by the discrimination, and only secondarily upon the benefits accruing to the discriminating party or parties.

The earliest of these cases makes this abundantly clear. *Terminal R.R., supra,* concerned a group of railroad companies that controlled all rail access to St. Louis by virtue of owning all the bridges into that city. There was no showing that the monopolist association had used this power in any way against rival railroads. The Supreme Court fashioned the bottleneck theory out of concern for potential abuse of monopoly power by a future denial of access to the essential facility. The Court's concern was not that the Association would contribute to its member railroad companies' power, but rather that non-member railroad companies would suffer from lack of access to the facility.

We fail to find in either of the contracts referred to any provision abrogating the requirement of unanimous consent to the admission of other companies to the ownership of the Terminal Company, through counsel say that no such company will now find itself excluded from joint use or ownership upon application. That other companies are permitted to use the facilities of the Terminal Company upon paying the same charges paid by the proprietary companies seems to be conceded. But there is no provision by which any such privilege is accorded.

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[37]It cannot be controverted that, in ordinary circumstances, a number of independent companies might combine for the purpose of controlling or acquiring terminals for their common but exclusive use. In such cases other companies might be admitted upon terms or excluded altogether. If such terms were too onerous, there would ordinarily remain the right and power to construct their own terminals. But the situation at St. Louis is most extraordinary, and we based our conclusion in this case, in a large measure, upon that fact. The "physical or topographical condition peculiar to the locality," which is advanced as a prime justification for a unified system of terminals, constitutes a most *obvious* reason why such a unified system is an obstacle, a hinderance and a restriction upon interstate commerce, unless it is the impartial

agent of all who, owing to conditions, are under such compulsion, as here exists, to use its facilities. 224 U.S. at 400, 405.

It requires a close reading of *Gamco, supra,* to discover that the corporate owners of defendant Providence Building were actually wholesaler competitors of the plaintiff. The Court's emphasis is not on the joint activity, but rather on the essential nature of the facility and the substantial harm suffered by Gamco in being denied access to it.

But it is only at the Building itself that the purchasers to whom a competing wholesaler must sell and the rail facilities which constitute the most economical method of bulk transportation are brought together. To impose upon plaintiff the additional expenses of developing another site, attracting buyers, and transhipping his fruit and produce by truck is clearly to extract a monopolist's advantage. 194 F.2d at 487.

In the *La Peyre* case, the La Peyre family enjoyed a lawful monopoly in certain machinery used in shrimp canning; this machinery was so efficient that its use became essential to compete in the shrimp canning business. The Commission challenged the family's practice of leasing its machines at twice the rental rate in the Pacific Northwest as in the Gulf Coast, and found that the discriminatory excess rental charge was the cause [38]of many West Coast wholesalers and packers operating at a loss, sometimes to the point of being driven out of business. *Grand Caillou Packing Co.,* 65 F.T.C. at 841–845. The appellate court emphasized that this practice did not involve "Robinson-Patman-type discrimination," but concerned a much broader, more far-reaching issue: "the duty of a lawful monopolist to conduct its business in such a way as to avoid inflicting competitive injury on a class of customers." 366 F.2d at 120. The court clearly held that the leasing practice of a single company constituted an unfair method of competition because it involved "the utilization of monopoly power in one market resulting in discrimination and the curtailment of competition in another." *Id.* at 121. Respondents in the case before us mentioned that the La Peyre family had shrimp canning operations on the Gulf Coast; thus their motive for leasing machinery at discriminatory rates could have been to cripple growing competition from the West Coast. However, the decision of the Fifth Circuit rests on broader grounds, as the above quotation demonstrates. Moreover, the Fifth Circuit subsequently explained its own decision in *La Peyre* as holding that the exercise of monopoly power to injure competition in an adjacent market itself violates Section 5. *Fulton v. Hecht,* 580 F.2d at 1249 n.2.

The concern in these cases that competition will be harmed by the

refusal to deal with a class of competitors is very strong. Accordingly, the product or service need not be utterly indispensible, *Hecht,* 580 F.2d at 992, or completely incapable of substitution, *Gamco,* 194 F.2d at 992; and a Sherman Act violation has been found even where customers are not totally excluded from the market, but merely placed at a competitive disadvantage. *Associated Press,* 326 U.S. at 13. Where an essential product or facility is involved, courts may even require procedural and substantive guarantees of fairness to justify exclusion or discriminatory treatment of customers. *Silver,* 373 U.S. at 361; *Gamco,* 194 F.2d at 487. **[39]**

The foregoing discussion of the significance of harm to competition in the line of precedent does not mean that a monopolist has an absolute duty to deal whenever some such harm is shown. On the contrary the demonstration of substantial injury to competition is merely the trigger which sets off a rule of reason analysis of the monopolist's reasons for refusing to do business with all. Because of the nature of this inquiry the duty to deal arises rarely, and only after an exacting balance of the equities. A supplier's general right to choose its customers, enunciated in *United States v. Colgate & Co.,* 250 U.S. 300 (1919),[46] will not be questioned unless and until the harm shown is substantial, and affects existing competition. When that degree of harm is established, the monopolist must show that its decisions which cause the harm to competition were made for substantial business reasons, not arbitrarily. And even if the decisions were made arbitrarily, the Commission will not impose a duty to deal if the order would require the Commission or enforcing courts to assume a continuing role in supervising business discretion. **[40]**

2. Monopoly Power

Whether GM is a monopolist is the threshold question under this

[46] The seller's freedom to trade enunciated in *Colgate* does have limits. It is only a general right, "neither absolute nor exempt from regulation." *Lorain Journal Co. v. U.S.,* 342 U.S. 143, 155 (1951). The circumstances under which a company's refusal to deal is not protected by this general right have been and still are being exhaustively explored on a case-by-case basis since *Colgate.*

In the monopoly context it is well to remember that *Colgate* in no way repudiated the essential facility doctrine enunciated in *Terminal Railroad,* decided seven years earlier. The market affected by Colgate's alleged practices was the manufacture of soap and toilet articles, a market totally different from that in *Terminal Railroad.* The railraod terminal was an essential facility; by contrast alternatives to Colgate's products were readily available. The importance of this distinction was later emphasized in *United States v. Arnold, Schwinn & Co.,* 388 U.S. 365 (1967). There, the Supreme Court restricted a manufacturer's right to confine his sales to selected dealers to situations where "competitive products are readily available to others" or where "other and equivalent brands . . . are readily available in the market." *Id.* at 376. *See also Elder-Beerman Stores Corp. v. Federated Department Stores, Inc.,* 459 F.2d 138 (6th Cir. 1972). Where an essential product is involved, therefore, the *Colgate* doctrine provides the monopolist no protection.

theory. To answer it we must determine the relevant product market.[47] Because there are no close substitutes for new GM crash parts, and therefore GM has nearly unfettered pricing discretion, the ALJ found the market to be new GM crash parts for GM automobiles and light trucks. (IDF 338–392) We agree with this finding. In this market GM has a 100% share, since it is the sole producer of all new GM crash parts. (IDF 68) Respondent contends that the ALJ wrongly excluded salvage (used) parts as reasonably interchangeable substitutes for crash parts.[48] Our review of the record convinces us that the ALJ was correct in his analysis of the interplay between the two products: while there is limited interchangeability, it does not amount to any degree of effective competition. Salvage parts are very imperfect substitutes for new crash parts. Availability is extremely limited in the early years of any type of crash part. Moreover, salvage parts cannot be used as easily as new crash parts: the used parts generally have to be repaired and are often not as good a "fit" to the car. Prices of the two types of parts appear to be highly independent. The fact that limited substitution is observed does not disaffirm the existence of monopoly power. At monopoly or exclusionary prices, we would expect to see some substitution, if at all possible. We therefore endorse the ALJ's classification of General Motors crash parts as a separate market on the basis of five of the *Brown Shoe* criteria: (1) specialized vendors; (2) peculiar characteristics and uses; (3) industry and public recognition; (4) distinct prices; and (5) lack of mutual price sensitivity. We incorporate by reference here IDFs 219–242 and 306–329. *See also United States v. Aluminum Company of America,* 148 F.2d 416, 425 (2d Cir. 1945); *Avnet Inc. v. Federal Trade Commission,* 511 F.2d 70 (7th Cir. 1975); *United States v. CBS, Inc.,* 459 F. Supp. 832, 838–39 (C.D. Cal. 1978). **[41]**

3. Harm

(a) Locus of Competition in Crash Parts

The question of whether a monopolist has arbitrarily refused to deal cannot be answered without first determining the nature and extent of harm caused by that refusal to deal. The more grave the effects on competition, the more substantial must be the monopolist's justification for its actions.

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[47] It is clear that the relevant geographic market is the United States as a whole. (IDF 330–336)

[48] Respondent also seems to argue that the proper market is new automobiles. (RAAB 28) It does not explain in any detail why the (crash) part is inextricable from the whole for purpose of product market definition. Certainly the price of crash parts has little, if any, effect on competition in the sale of new automobiles. Nor are GM crash parts interchangeable with crash parts for other manufacturers' cars. In this regard we note that in *FLM Collision Parts, supra,* both the District Court and Second Circuit accepted that Ford had a monopoly on crash parts manufactured exclusively by Ford for Ford cars. 543 F.2d at 1030; 406 F.Supp at 227–28, 246.

Thus, our second step in constructing the balance is to find the locus of competition in crash parts. To do so requires a clear understanding of the functions performed with regard to crash parts by the only entities currently involved as conduits in the intermediate (post-manufacturer, pre-retail) stage of crash parts distribution: GM and its franchise dealers. Below the manufacturing level GM has only one function, that of warehousing or primary wholesaler (through GMPD). The dealers are in a more complex situation. While most dealers install crash parts in their own bodyshops, only some dealers both wholesale at a secondary level and install a dealership's crash parts. Keeping a firm conceptual distinction between the wholesaling and installing functions is essential. For the remainder of the opinion we will refer to dealer-installers and dealer-wholesalers in order to help clarify this vital functional distinction.[49]

All relevant business transactions with the IBS are performed by dealers in their role as dealer-wholesalers.[50] It is in this capacity, as suppliers of crash parts to the IBS, that dealers receive wholesale compensation from GM.

The second function a dealer may perform is to operate a dealer body shop where crash parts are installed. It is in this bodyshop operation which, as an installer and retailer of crash parts, a dealer competes with the IBS in collision repair work. Dealers do not receive wholesale compensation for crash parts which are used in their own body shops. [42]

It is helpful to keep in mind that every individual crash part must be handled by a dealer before it is installed by either a dealer-installer or by an IBS in a consumer's vehicle. However, crash parts which are installed by an IBS are only handled by dealers in their capacity as dealer-wholesalers. That is, any individual part purchased by an IBS from a dealer-wholesaler is never handled by a dealer in its capacity as dealer-installer. While this distinction may seem obvious and somewhat trivial, failure to make it resulted in the ALJ's erroneous determination that the wholesale compensation plan, rather than the selective crash parts distribution system, is what gives dealer-installers a competitive edge over the IBS. This framework also makes it clear that wholesale compensation should not be subtracted from GM's warehouse price in computing the cost

[49] We reserve the word "dealership" for occasions when distinction between distribution functions is unnecessary.

[50] As described at IDF 76, dealer-wholesalers may also supply crash parts to customers other than IBS, and such transactions may or may not qualify for wholesale compensation under the WCP. These transactions have no bearing upon the present discussion.

to a dealer of crash parts which will be installed in his body shop, as opposed to used by IBS.[51] The WCP rebate is simply irrelevant to a comparison of the prices which IBS and dealer-installers pay on crash parts to be used in their respective body shops.

On the point of competitive injury, complaint counsel argue that two functionally distinct groups of businesses are affected: the independent body shops (IBS) and the independent wholesalers (IWs). We agree that both are adversely affected (though to different degrees) By GM's refusal to deal, but only in the case of the IBS does the lost opportunity to buy crash parts directly from GM also translate into harm to competition.

1. *Independent Wholesalers*

IWs play a large role in the automotive aftermarket. (*See generally,* Nelson Tr. 13719–20, 13758–13761; IDF 49, 129–140) They may be either warehouse distributors (redistributing wholesalers) or "jobbers", who sell directly to repair outlets. For the purposes of this analysis it is not necessary to distinguish between jobbers and warehouse distributors.[52] The key factor is that neither currently handles crash parts. General Motors is the only entity currently engaged in primary wholesaling or warehousing of crash parts. [43]

If GM sold crash parts to IWs they would replace or rival GM's thirty-six GMPD warehouses and seven parts plants. They are, to borrow a term from merger law, potential entrants[53] into the business of crash parts wholesaling. There is no actual competition at this distribution level: GM by forward integration has pushed its monopoly over the production of crash parts into the first level of crash parts distribution.

Forward vertical integration by a manufacturer can be implemented for legitimate competitive reasons, such as distribution efficiencies and profit maximizing based on lower prices and higher output. Accordingly, it is condemned under the antitrust laws only when it has the collateral purpose or effect of achieving some anticompetitive advantage for the integrating company. For example, a manufacturer may not integrate forward if that action amounts to an attempt to monopolize the downstream distribution level. *E.g., Eastman Kodak Co. v. Southern Photo Materials Co.,* 273 U.S. 359 (1927); and commentators have suggested that forward

[51] Those portions of IDFs 119–128, 401, 405 which state or imply otherwise are specifically rejected.

[52] More precise definitions are given at Abston Tr. 12489–90; Nelson Tr. 13719–20; *see also* Davisson, The Marketing of Automotive Parts, Michigan Business Studies, Vol 12. No. 1 at 956–958 (Ann Arbor: University of Michigan Press, 1954).

[53] We do not need to resolve the conflict in the record over whether IWs have the desire as well as the capability to enter into crash parts wholesaling.

vertical integration should not be allowed when it is a device for maintaining monopoly at the manufacturing level by raising entry barriers to would-be manufacturing competitors who could not independently distribute their goods efficiently. *See* Areeda and Turner, III *Antitrust Law* ¶726d3, ¶726d5 (1980). However, as we have already acquitted GM of any anticompetitive purpose in its choice of a distribution system, the examples above are not relevant to our analysis.

We do not think the duty to deal requires a monopolist to set up rivals to itself; the duty merely requires the monopolist not to discriminate arbitrarily between existing classes of competitors. Similarly, the duty to deal does not require a monopolist to create competition in a subjacent market where none exists. Thus, the IWs' position as mere potential competitors of dealer-wholesalers does not entitle them to the advantages of a place in GM's distribution system. Even a monopolist has a general right unilaterally to decide with whom it will deal in the first instance, absent any improper purpose. *United States v. Colgate & Co.,* 250 U.S. 465 (1919). Certainly if failure to expand a distribution network of a fixed number of primary distributors were illegal, every selective distribution system would be in jeopardy. [44]*Aviation Specialities, Inc. v. United Technologies Corp.,* 568 F.2d 1186, 1192 n.10 (5th Cir. 1978). We do not think that the duty to deal sweeps this broadly. Only when the monopolist's refusal to deal creates disequalities among existing competitors will the monopolist have to justify its choice of a selective distribution system.

2. *Independent Body Shops*

IBS are actual, not potential competitors of dealer body shops in the retail and installation of crash parts. Accordingly, we develop the harm side of the equation by analyzing the extent to which GM's refusal to deal retards the IBS' competitive strength.

(b) The IBS' Competitive Position

1. *What the IBS Pay*

The record is uncompromising on the fact that the IBS pay significantly more for crash parts than GM dealer-installers. General Motors sells all crash parts—whether or not eligible for wholesale compensation—to its dealers for list less at least[54] 40%. (IDF 119,

[54] Approximately 50% of dealers' orders are routine stock orders (PAD orders) and so are eligible for an additional 5% discount. This brings the price down to 43% off list. (IDF 120, 122, 190(1), 195, 248)

248) In contrast to this dealer-installer cost[55] every one of 26 IBS witnesses[56] from seven trade areas testified that his invoice cost on crash parts during the last six-to-seven years averaged between 22% and 31% off list price. (Neibling Tr. 2533, 2534, 2538; Craft Tr. 2910; Perschall Tr. 3086; Clouatre Tr. 3635; Trepagnier Tr. 3845; Lakatos Tr. 4008–4009; Clark Tr. 4218; Serwacki Tr. 4811, 4840; Whitman Tr. 4991, 4992; Barney Tr. 5231; [45]Baker Tr. 6183, 6184; Hershey Tr. 6569; Weatherford Tr. 6712, 6715, 6716; Newman Tr. 5713, 5714; Crigger Tr. 5785; Brokaw Tr. 5977; Smith Tr. 7353, 7354; Rouse Tr. 6929, 6930; Albertin Tr. 8241; Finkle Tr. 9324) Seven GM dealers and parts managers testified that their selling price (wholesale price) to IBS was generally within the range of 22%–31% off list. (Schaeffer Tr. 10665; Sutliff Tr. 11019–020; Tribo Tr. 10847–848; Bogard Tr. 10489–490; Mehaffey, Tr. 11222; Boyd Tr. 11853–854; Denton Tr. 12011–012) This testimony is confirmed by a stipulated summary of some 5,000 invoices[57] issued by 82 GM dealers to the IBS witnesses. The summary, reproduced below, shows average crash parts discounts for the seven trade areas over three years:

AVERAGE DISCOUNT
(% off list price)

Trade Area	1974	1975	1976
Buffalo, N.Y.	–	28	29
Mansfield, Ohio	–	26	27
Cleveland, Ohio	26	28	28
New Orleans, La.	27	30	29
St. Louis, Mo.	–	27	28
Spokane, Wash.	26	25	25
Tucson, Ariz.	28	31	26

(CX 5706, Second Revision; IDF 118) [46]

Respondent argues that this summary of average discounts does not accurately reflect the real world of crash parts discounts. GM urges us instead to look at the summary it has compiled of a few

[55] In this opinion we follow standard accounting terminology whereby "cost" means the amount a buyer pays for a product, and "price" means the amount for which a seller sells a product. Although GM dealers commonly refer to their list-less-40% cost of crash parts as "dealer price", we will avoid using that description, in the (perhaps vain) hope of avoiding confusion.

[56] Twenty-four witnesses actually testified; the testimony of two additional witnesses was stipulated as being cumulative. (Tr. 15445–46)

[57] The invoices appear in the record as CX 2 through CX 5373. The record also contains two sets of documents which organize the data from CX 2 through CX 5373 as follows: (1) summaries of each IBS' dealings with each GM dealer, showing the specific crash part purchased, its list price and dealer wholesale price, and the discount the IBS received, expressed as a percentage off list price (Revised CX 5374 through Revised CX 5699); (2) summaries of total yearly crash parts purchases by each IBS, showing the volume of crash parts purchases in terms of GM's list price and at the dealer's wholesale price, and calculating an average discount, expressed as a percentage off list price. (CX 5700–CX 5701, Second Revision; CX 5702–CX 5705, Revised)

instances where some of the IBS witnesses were able to get slightly higher discounts on individual crash parts or certain lines of crash parts. (RAB 9–10) GM lists thirty-two instances where an IBS testified to receiving a discount equal to or in excess of the discounts shown on CX 5706, Second Revision. What respondent does not reveal, however, is that these instances of "excess" discounts were all taken from the very invoices which are the basis for the averages shown in CX 5706, Second Revision. The "excesses" are part of the average, just as are the many instances in these invoices of a sale for far less than 27% off list.[58] Thus respondent has in no way impugned the methodology of complaint counsel's calculations on the average crash parts discounts received by IBS.

Respondent next argues that the testimony and documentary evidence reflected in CX 5706, Second Revision, even if internally consistent, should not be extrapolated to represent public injury, but should be used to show only the private woes of the twenty-six IBS witnesses. (RAAB 11) We do not agree that complaint counsel's sampling technique inherently gives an unreliable picture of the IBS situation nationwide. [47]

First, as a matter of proof, it would be an intolerable burden to require complaint counsel to survey the universe of IBS. They are entitled to present examples of the situation obtaining with regard to crash parts discounts rather than having to paint the whole picture. We note that this procedure was followed in *Associated Press v. U.S.*, 326 U.S. 1 (1944), in which twenty-six cities were illustrative of a national situation. *See also, The Coca Cola Co.*, 91 F.T.C. 517, 617–18 (1978). Respondent can then challenge the validity of these examples by showing them to be either inherently unreliable or else not representative. As noted above, repondent has failed to show internal inconsistencies in the data for the seven trade areas; as for the matter of non-representativeness, GM states this to be the fact, but has not backed up this statement with any comparable evidence of its own.[59]

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[58] For example, respondents got IBS witness Britvic to "admit" that he received an average discount of 32.1% on Chevrolet crash parts during 1975. For an on-the-stand mental calculation of thirteen invoices this is not too inaccurate. (CX 1485–89, 1491–93, 1495–98, 1503, 1505–07) In actuality, his average discount on Chevrolet crash parts during that time was 30.2%, but that is still undeniably higher than the overall Cleveland average discount of 28% for 1975, as shown in CX 5706, Second Revision. However, complaint counsel did not ignore the Britvic Chevrolet crash parts average when computing the Cleveland all-crash parts discount. (CX 5706, Second Revision) Britvic's discount on Chevrolet crash parts is scrupulously factored into his total crash parts average discount of 28.2%, which is also made up of his other average discounts of 25% on Buick, Oldsmobile and Cadillac line crash parts and 36% on Pontiac line crash parts. Averaged all-crash parts discounts for three other IBS were developed in the same way as Britvic's and all factored into the final Cleveland figure.

[59] Without listing all the ways in which GM could show that complaint counsel's choice of trade areas was a gerrymandered one, we note that GM produced no IBS witnesses from trade areas of its own chosing to testify that they consistently paid 40% off list on an average of all lines of crash parts. Nor did GM produce invoices from which such a conclusion could be drawn. Instead, GM's rebuttal consisted of scattershot testimony, almost entirely

(Continued)

Moreover, there is some support in the record for a nationwide extrapolation of the IBS situation from complaint counsel's seven trade areas. Most important, of course, is the already-noted testimony of seven GM dealers and parts managers as to their standard level of discount. These witnesses represent five locations beyond complaint counsel's chosen trade areas.[60] To a lesser, but not insignificant degree, support may be found in the testimony of representatives of three national automobile insurance companies [48]and of three large regional wholesalers, who opined that the average discount received by IBS and GM crash parts ranged from 25–30%. (CPF 109)[61] While not direct proof of the terms of any dealer-IBS sales, this third party testimony is independently corroborative of the statitstics previously compiled. Its reliability stems from the fact that both insurance companies and independent wholesalers made these observations for business purposes. In particular, the insurance companies in part adjust their business relations to IBS according to their perceptions of the IBS' materials costs. Insurance company service representatives constantly visit both IBS and dealer bodyshops. In the context of what discount the insurance company can get, the topic of the cost of crash parts often arises: [49]

They have gripes, sir. They like to get things off their chests, the body shops especially . . . . Some things you have to take with a grain of salt but we check into some things. Sometimes it goes as far as they want to demonstrate what they are doing and actually show you an invoice or something. (Rhoads Tr. 1203, 12100. *See also* Holschen Tr. 1669, 1672, 1684; Durbin Tr. 1355–58, 1407–09.)

The IWs' observations were made with an eye towards the profits available in crash parts distribution could they enter, and general

from GM dealers or parts managers, referring to occassional pricing variations on one line of crash parts, or even one type of crash part. (RPF 141; CRF 141) This testimony is not of like nature to and cannot outweigh the carefully constructed case presented by complaint counsel.

[60] The additional locations represented by GM dealers and parts managers are: Harrisburg, Pennsylvania, (Sutliff); Memphis, Tennessee, (Schaeffer, Tribo and Bogard); Akron, Ohio, (Mehoffey); Indianapolis, Indiana, (Boyd); and Phoenix, Arizona, (Denton).

[61] The representatives of the national automobile insurance companies and regional wholesalers and their testimony appear in the record as: (1) R. Holschen, Claims Consultant, State Farm Mutual Insurance Company. Based on his experience in his assigned areas of Illinois, Wisconsin, Minnesota, Colorado, Utah, Wyoming, Alaska, Washington, Oregon, Idaho, and Montana, Holschen testified that discounts on the relevant parts to IBSs range from 12% to 30%, averaging about 25%. (Tr. 1667, 1689) (2) W. Rhoads, Home Office Property Claims Director, Allstate Insurance Company. Rhoads testified to an average discount of 25%–30%. (Tr. 1206) (3) R. Durbin, Manager of Material Damage, The Reliance Insurance Company. Durbin testified to an average of 30%. (Tr. 1347, 1354, 1407–1408) (4) H. Franck, Owner, Abrasive Supplies, Long Beach, California. Franck is an IW currently serving the states of Nevada and California who has previously sold in Washington and Oregon. The best discount he has observed is 25%. (Tr. 6396–97, 6400) (5) D. Fort, Owner, Fort's Exports, Charleston, South Carolina. Fort testified to an average discount of 25% in Southeast Florida, an area where he conducts business. (Tr. 9002–03) (6) J. Jordan, President, Keystone Automotive Plating, Pamona, California. Jordan testified to an average discount of 25% on GM bumpers nationwide, but with three metropolitan areas (Newark, Baltimore, Philadelphia) currently having somewhat greater discounts. (Tr. 7797–98)

performance comparisons between the IW and the dealer-wholesaler. (Franck Tr. 6400–01; Jordan Tr. 7793–97)

2. *What Dealer-Installers Pay*

In contrast to the average IBS cost of list less 27% or 28%, GM dealers can purchase any crash part for a cost of list less 40%. (IDF 399) Parts purchased by stock order (PAD order) receive an additional 5% discount (IDF 119, 190(1), 248), bringing their cost down to 43% off list. A significant number of crash parts are ordered "on the PAD" and so are subject to the greater discount.[62] Thus, on average there is a 17.7% cost differential between IBS and GM dealer-installers, to the IBS' disadvantage. (Nelson Tr. 14536, 14561–62; IDF 398) This is more clearly seen with a part having a hypothetical $100 list price: the IBS' cost is $72 to $73 (28–27% off list) while the dealer-installer's cost is $57 to $60 (43–40% off list), depending on method of ordering. **[50]**

Respondent argues that invoice cost is not a proper basis for comparison. GM would have us take into account the costs which dealers incur in performing a wholesaling function for their own body shops. Since there is no record evidence of the real economic costs of transferring a crash part from a dealership's "front office" to its bodyshop, GM would have us do as the majority of its dealers do and use its suggested transfer price of 25% of the dealer's cost.[63] Doing so raises a dealer's total parts accounting cost to 25% off list, which shows to no advantage against the average IBS cost of 27–28% off list. Put in terms of our crash part with the hypothetical $100 list price we see:

List	$100
Dealer cost	$ 60 (40% off list)
Transfer cost	$ 15 (25% off dealer cost)
Total accounting cost	$ 75 (25% off list)

All this amounts to, however, is a piece of accounting legerdemain, designed to lodge a portion of the profits from a crash parts sale in a dealership's parts and accessories profit center[64] rather than in its bodyshop profit center. The assigned markup figure could just as

[62] GM parts specialists hold that a well-run dealership will order 80% of its crash parts "on the PAD". (IDF 192) However, in actual practice dealerships, especially those near GMPD warehouses, tend to rely more on *ad hoc* orders, which qualify only for the basic discount of 40% off list. (IDF 192, 195). The ALJ endorsed complaint counsel's expert's estimate that approximately 50% of crash part orders are "on the PAD". (IDF 122)

[63] The manager of GM's Dealer Business Management Department testified that 60% to 65% of all GM dealers use GM's recommended transfer price of 25% of dealer price. Some use an equally artificial transfer price of 30% of dealer cost. (Vasquez Tr. 11424)

[64] The major functions of P&A Departments are wholesaling, sales of warranty parts, internal transfers to service departments, internal transfers to body shops and over-the-counter sales. (RX 40)

well be 10% or 40% of the dealer cost, since it is admittedly not an accurate picture of a dealer's transaction cost. (Vasquez Tr. 11421–11422; Nelson Tr. 14016; Benston Tr. 16173–78) Indeed, before GM started recommending the use of a 25% transfer cost in 1976, dealers [51]used a transfer cost of the actual retail sales prices charged by their body shop, *i.e.*, took all their profits at the "front office."[65]

The artificiality of GM's suggested transfer cost is also apparent from the disparate patterns of new crash parts and salvage crash parts purchases by IBS as opposed to dealer-installers. Despite the higher total cost of new crash parts to the dealer-installer (once the transfer cost is counted), dealer-installers do not turn to the imperfect but cheaper substitute of salvage crash parts, as do their IBS competitors. Since GM does not require that dealer-installers use only new crash parts,[66] it is obvious that the transfer cost is merely an accounting fiction: it plays no role in a dealership's decision-making. [52]

As a final point we note that some portion of the dealership's 25% transfer cost may represent real costs associated with administration of crash parts ordering.[67] Even so, for a valid comparison we would need to know an IBS' administrative costs. As these are not available, the invoices remain that most even-handed method of comparing what IBS and dealer-installers pay for crash parts. The conclusion is inescapable: IBS as a class pay much more.

3. *Services*

GM's selective distribution system for crash parts also puts the IBS under some non-price disadvantages in comparison to dealer-installers. The major one is speed of delivery. Dealer-installers have five methods of ordering crash parts from their assigned GMPD

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[65] Q. Parts and accessories buys the part for $60. Sends it over to the mechanical shop. Mechanical shop installs it and charges the customer $100. Now, what would be the setup on the books of the parts and accessories department for the sale price and purchase price of that part?

A. When did this happen?

Q. Prior to January 1, 1976.

A. The parts department would have a sale of $100 with a cost of sixty.

Q. Fine.

A. Nothing would happen in the body shop.

Q. Then after January 1, 1976, how would it show up on the books of the two departments?

A. You would have a sale in the parts and accessories department. If they were recording the sales in accordance with our recommendations of $75 with a cost of $60. And then you would have a sale of the part in the body shop for $100 with a cost of . . . $75. So you have $15 gross profit in one department and $25 in the other, a total of $40. (Vasquez Tr. 11498–11499)

[66] The Dealer Sales and Service Agreement (RX 2) contains no requirement that GM dealers install only new crash parts; nor do we find any testimony in the record of such a requirement.

[67] According to complaint counsel's expert, the only administrative costs associated with a dealer's ordering parts for his own body shop are the minor cost of looking up the part number and filling out the order form. This amounts to, at most, 2% of the dealer's sales price. (Nelson Tr. 14017–18, 14020, 14559) One parts manager for a GM dealership stated that filling out crash part orders is probably the easiest administrative task of a dealer's parts department. (Denton Tr. 12033–34)

warehouse, four of which provide shipment of the part immediately or within 36 hours after the order is placed. (IDF 190, 191, 193) By contrast, IBS, even if located next door to a GMPD warehouse, must obtain the part from the appropriate franchise dealer. If the part is in stock at the dealer's, an IBS may be able to have it in a few hours; but the normal delivery time, even when the part is in the dealer's inventory, is 24 hours. (*See, e.g.,* Daniels Tr. 2451–52; Niebling Tr. 2517–18; Clouatre Tr. 3773–75; Trepagnier Tr. 3841–42)

The wait is much longer, however, when the dealer must order the part, which happens frequently. When this happens, even in the GMPD warehouse cities of Buffalo, St. Louis, Cleveland and New Orleans, IBS commonly experienced delays of three days to a week in receiving parts ordered on their behalf by a dealer-wholesaler from the local warehouse. (Daniels Tr. 2277–78; Clark Tr. 4151–52; Britvic Tr. 7503; Trepagnier Tr. 3841–43) Moreover, the IBS does not receive the part directly from the GM warehouse, as does the GM dealer; the part going to the IBS must be routed through the dealer-wholesaler. **[53]**

IBS may also be disadvantaged on ordering and supply convenience. A GM dealer generally goes to one source for all his crash part needs. If his assigned GMPD does not have the needed part in stock, it undertakes to find and arrange for delivery of the part through computer link-ups with all other GM warehouses and, if need be, GM itself. (IDF 176, 180) By contrast, since dealers tend to wholesale only the crash parts applicable to their franchise,[68] an IBS has to contact many different suppliers: the Buick dealer for Buick crash parts, the Cadillac dealer for Cadillac crash parts, etc. Not having a "one stop supplier" means increased delay and administrative expenses in ordering crash parts, as well as decreased ability to bargain for the best price or establish credit terms.

Q. I would like you to compare the advantages and/or disadvantages of being able to purchase products for all makes of car as opposed to having to go to various sources of supply for each make of vehicle.

A. I would think it would be an advantage, deliverywise. I would have less calling. I make anywhere from 20 to 50 calls a day calling various dealers in supplying myself, where I could limit that down to maybe 5 calls instead of 20 to 50. I think it would be a lever in getting better service if one man had all my business in your GM line. (Latakos Tr. 4034–35) (*See also* Perschall Tr. 3164–65; Franck Tr. 6413; Niebling Tr. 2594)

However, when it comes to delivery terms, IBS and dealer-installers seem to be on roughly equal ground. GM routinely prepays

[68] The Wholesale Compensation Plan is not, as might be suspected, responsible for this tendency. Even before 1968 dealers generally wholesaled only their line of crash parts. (RPF 34; Sutliff Tr. 11025–26; Perkins Tr. 9871–74)

freight expenses on the majority of its dealers' orders. (IDF 190) There is no such nationwide uniformity of easy credit terms on delivery for IBS; on the other hand, it appears that many dealer-wholesalers provide free delivery, at least locally. (Rhoads Tr. 1200; Bogard Tr. 10477–78; Mack Tr. 11570–71; Denton Tr. 12003–04; Tribo Tr. 10827; Baker Tr. 6193–94; Daniels Tr. 2277; Barney Tr. 5240; Serwacki Tr. 4902) Some even absorb freight charges on wide-area deliveries, if the order is average-sized or larger (IDF 117) [54]

Return policies show a similar lack of major disadvantage to the IBS. A dealership's parts return privileges allow returns for any reason, up to certain financial limits.[69] The IBS have no assurance, and the record does show that some dealer-wholesalers charge a fee for returns. (Wicker Tr. 5560; Hershey Tr. 6563; Weatherford Tr. 6789–90) On the other hand many other dealers provide liberal return privileges, some even without charge. (Smith Tr. 7419; Britvic Tr. 7506; Neal Tr. 7937–38; Finkle Tr. 9434) In sum, the record does not show that IBS consistently receive less accommodation on delivery terms than do their competitors, the dealer-installers.

Finally, we conclude that GM's selective distribution system for crash parts does not withhold from IBS any vital technological assistance. In the first place, no great amount of technological expertise is necessary for performing body repair work, as compared, for instance, to the repair of a vehicle's emissions control system. Secondly, GM dealers themselves receive almost no technical assistance from GM concerning crash parts installation. (Murray Tr. 10019, 10021, 10030)

(c) Effects

1. *Insurance Work*

The record does not show precisely how IBS businesses are affected by any nonprice disadvantages on crash parts delivery. There is of course testimony confirming the obvious fact that easy availability and comparable delivery costs are important to an IBS' ability to compete in crash parts installation. (*See e.g.,* Perschall Tr. 3273; Serwacki Tr. 4875; Clark Tr. 4176; Smith Tr. 7474–75) The price discrepancy, however, is clearly key to the problems IBS face in getting insurance-paid business. [55]

Approximately 90% to 95% of all crash repair business done by bodyshops, independent and dealer, is paid for by insurance compa-

[69] Dealers can return parts for credit and without charge up to an amount called the Maximum Return Reserve. The Maximum Return Reserve is earned by the dealer at the rate of eight percent of stock ("PAD") orders (and initial orders and "qualified special merchandising orders") and four percent of supplemental stock orders. Dealers are charged a penalty of 20% for returns in excess of the Maximum Return Reserve. (RPF 33)

nies. (IDF 200) In the interest of cost control, most major insurance companies have adopted a system of recompense which allows the insured to go to the repair shop of his or her choice, but sets upper limits on the amount of the claim. If the cost of repair exceeds the insurance company's limits, the claimant must pay the excess. (IDF 201; Holschen Tr. 1690; Hershey Tr. 6666–67; Rouse Tr. 7026; Britvic Tr. 7547; Albertin Tr. 8286–87) Obviously then, car owners have great incentive to go to body shops which can meet the insurance company's appraisal for repair of crash-damaged vehicles. This incentive is reinforced by the fact that most insurance companies provide their claimants with lists of "preferred", "one-stop" or "competitive" bodyshops, meaning shops which have agreed in advance to accept the insurance company's estimate of repair cost.[70] (IDF 205) A very large portion (40%–80%) of insurance-paid work is performed by bodyshops to which the claimant is referred in this manner by the insurance company. (Weatherford Tr. 6862–63; Rhoads Tr. 1217; Hoschen Tr. 1690)

Getting on the "preferred" list, or at least being able to do repair work within the limits of an insurance company's estimate, can therefore be crucially important to a bodyshop's ability to stay in business. There are three elements of a repair appraisal which can be adjusted by a bodyshop to bring the overall final cost of the job within the estimate: time, labor rate and crash parts discount. The last is by far the most significant.

Insurance company appraisers use standard "crash manuals" to determine the time needed for each type of repair job. (Durbin Tr. 1449) Payment is made on estimated rather than actual work time. Thus, if a bodyshop can consistently "beat the book", *i.e.* do the job in less time, it can use all or a portion of the amount **[56]**recompensed for unnecessary hours to provide leeway for adjustments on the other two elements. (Whitman Tr. 5017) However, both the natural bounds of labor efficiences and the shop's desire to do quality work limit how much time can be shaved on any job. (Whitman Tr. 5016) Witnesses uniformly spoke in terms of lopping "an hour or two" per job. (*See, e.g.,* Serwacki Tr. 4836; Whitman Tr. 5016–18; Hershey Tr. 6629–30) This does not translate into particularly high savings. For example, at a $15.00 per hour labor rate,[71] a heroic 25% reduction

[70] This is a "gentleman's agreement" rather than a formal contract; adjustments in the final figure can be negotiated. However, such negotiations generally take place after repairs have begun and are limited to items overlooked by the adjustors. It is not surprising, therefore, that one insurance company representative estimated that 75% to 80% of all estimates are accepted without change by "preferred" shops. (Rhoads Tr. 1221–22, 1322)

[71] This was a 1978 rate referenced by Buffalo witnesses. In the other trade areas labor rates for 1978–1979 ranged from $11.00 to $15.00. Tucson: $11 (Brokaw Tr. 6029), New Orleans: $12 (Trepagnier Tr. 3978–79), Spokane: $14 (Rouse Tr. 7026) Mansfield, Ohio: $14 (Hershey Tr. 6611–12), St. Louis: $15 (Daniels Tr. 2346).

in time on an eight hour job[72] produces only a $30.00 saving.

This brings us to the second means of meeting an estimate—discounting the stated labor rate. Insurance companies use the "prevailing" or "going" labor rate for the area in writing estimates. (Tr. 1450–51) Theoretically, a bodyshop could offer a lesser rate to balance higher parts costs or longer than average time per job. Unfortunately, in many areas labor rates are simply not adjustable, being negotiated by unions and generally followed by even non-union shops, IBS and dealer-installers alike. (Durbin Tr. 1440; Clark Tr. 4185–86)[73] More importantly, given their relative importance as components of the overall claim, it would take a massive adjustment in the labor rate to offset a minor discount on crash parts. Several IBS witnesses gave variations on this example: to replace a front end takes 8-10 hours of labor; reducing a typical $14.00 per hour labor rate by 10% results in a saving of $11.20 to $14.00 on a front-end job; but since the aggregate cost of the relevant crash parts (headlights, grille, bumper, fenders, hood radiator support) ranges from $1200 (Chevrolet) to $2200 (Cadillac), a reduction of 10% on parts produces a savings of $120–$220. (Serwacki Tr. 4836, 4841; Barney Tr. 5364–65; Whitman Tr. 5013) [57]

This shows why the third means of meeting the estimate, discounting crash parts, is paramount. Insurance companies uniformly demand a sizeable discount on crash parts. Such is their buying power—as the ALJ noted, insurance companies are the real consumers of almost all crash parts (IDF 200)—that no body shop can get on a preferred list without acceding to the crash parts discount prevailing in his locality. (IDF 206)

In each of complaint counsel's seven trade areas we are presented with a picture of GM dealer-installers consistently giving at least a 10% discount on all crash parts and frequently more, up to as much as 25% on certain parts. (IDF 208, 209) In contrast, the IBS often cannot give any discount, rarely manage more than 10%, and that only with difficulty. The following chart summarizes the testimony on comparative crash parts discounts in the seven trade areas:

Area	GM Dealer-Installer Discount	IBS Discount	Source
Buffalo, N.Y.	10–25%	0–10%	IDF 209
Cleveland, Ohio	10–25%	no more than 10%	CPF 138; IDF 208

[72] The time required for a full front-end replacement (Serwacki Tr. 4836). Many other jobs require less extensive repairs, and consequently offer less scope for savings through speed.

[73] We doubt that any body shop owner would dare deny the prevailing labor rate to his "heavy hit man". (Serwacki Tr. 4829)

Area	GM Dealer-Installer Discount	IBS Discount	Source
Mansfield, Ohio	?	?	CPF 139; IDF 209
New Orleans, La.	10–20%	0–10%	IDF 209
St. Louis, Mo.	10–25%	no more than 10%	CPF 138; IDF 208
Spokane, Wash.	10–20%	0–10%	IDF 209
Tucson, Ariz.	10–25%	no more than 10%	CPF 138; IDF 208

The overall amount of insurance-paid business lost by reason of the IBS' failure to match dealer-installer crash parts discounts is not quantified, and being in the nature of an "if [58]only" probably cannot be.[74] However, the record is replete with testimony that such business is so lost; the witnesses include insurance company representatives as well as IBS operators. (IDF 211–212) The following are typical:

Our margin of profit is determined by two things: labor and price discount. The price discount is what gives us our lifeblood, and when they take some blood away. . . . If they gave me 10 percent, I would have still been in business today. I still want to fix cars. I love cars. It's everything I've ever done all my life. I couldn't fight it anymore. I can't work until 3:30 in the morning anymore. I don't want to be found dead at 2:00 in the morning alongside one of my cars. (Serwacki Tr. 4869–70)

I am talking about the one and two-man shops that work many hours a day, a lot of evenings and have the highschool kids or whatever coming in and helping them evenings and on Saturdays. A lot of those disappear and go away. (Daniels Tr. 2310)

The examples in the record are sufficient to support the proposition that the IBS are substantially harmed by the cost discrepancies which stem from GM's selective distribution system for crash parts. [59]

2. *Statistical Proof*

To go beyond the examples cited above of the IBS' lost insurance work in search of statistical proof of harm to the IBS is to labor in a

[74] We know that 36–54% of IBS revenues come from sale of all makes of crash parts. (CPF 122) We also know that in the crash part universe the ratio of GM crash parts to other types of crash parts corresponds to the ratio of GM cars on the road as compared with other makes: in 1976 that ratio was 45.5%. (CPF 123) Thus, if IBS could get all the GM crash parts they need, we would expect GM crash parts to account for 16.38%–24.57% of IBS revenues from parts sales. A lower percentage would indicate inability to get GM crash parts. However, we cannot make such calculations because the record nowhere breaks out the percentage of IBS revenues attributable to sale of new GM crash parts.

However, we should also note that a showing that IBS achieved 16.38%–24.57% revenues from sales of new GM crash parts would not necessarily prove lack of discrimination. The starting figure for these calculations (36–54% revenues from sales of all makes of crash parts) has a built-in bias, reflecting a world where no major car manufacturer will sell its crash parts directly to IBS.

barren field. Whittier summed up the problem: "For all sad words of tongue or pen, the saddest are these: 'it might have been!'" More prosaically: it is impossible to gauge the amount of business lost due to a refusal to deal which has not been preceded by a course of dealing. There is no yardstick against which to measure the loss, no before and after,[75] no minuend from which to subtract.

If this were a private cause of action for damages resulting from a refusal to deal, the inability to quantify harm could be fatal.[76] However, even in private cases where damages are too [60]speculative to support recovery, courts have acknowledged that proof of the fact of injury is an entirely different matter from proof of the quantum of damage. *See, e.g., Zenith Radio Corp. v. Hazeltine Research, Inc.,* 395 U.S. 100 (1969); *Fleer Corp. v. Topps Chewing Gum, Inc.,* 501 F. Supp. 485 (E.D. Pa. 1980).[77] Section 4 of the Clayton Act, which requires proof of private injury as a prerequisite to a damage recovery, is of course not imposed upon the government, which generally proceeds to enforce the antitrust laws by suits in equity, undertaken in the public interest. Thus in all the cases previously discussed which produced a duty to deal order, nowhere did the government have to measure the injury to competition with statistical precision. For example, in *Otter Tail Power Company Co. v. United States,* 373 U.S. 341 (1963), the refusal to deal, on its face, supported equitable relief. The Court inferred that municipalities

[75] The terms "yardstick" and "before and after" are borrowed from the jargon of computing lost profits in private damage actions. The yardstick theory relies on an analogous class of unharmed competitors whose sales during the damaged period can be used to approximate what the plaintiff could have achieved. The before and after theory looks to the plaintiff's own sales history just before the supplier began to refuse to deal and extrapolates from that. Neither theory can be used here. The IBS have never been able to buy crash parts directly from GM; consequently, they can furnish no prior sales history. The dealer bodyshops are the IBS' only competitors, and while they are similarly situated enough to allow the crash parts invoice cost comparisons described earlier, their position as a part of a much larger business precludes meaningful comparisons to the IBS on profits, growth and failures.

[76] In the private action arena extensive debate exists over what degree of proof is necessary to measure the degree of harm caused by an antitrust violation. *See, e.g.,* Harrison, *The Lost Profits Measure of Damages in Price Enhancement Cases,* 64 Minn. L. Rev. 751 (1980); L. Sullivan, Handbook of the Law of Antitrust Section 251 at 785 (1977); Gibson, *The "Market Share" Theory of Damages in Private Enforcement Cases,* 18 Antitrust Bull. 743 (1973); Guilfoil, *Damage Determination in Private Action Suits,* 42 Notre Dame Law. 647 (1967). The underlying issue is, of course, how to achieve a balance between a strong judicial policy against speculative damages, and a disinclination to favor the wrongdoer whose wrong doing is the most effective and complete—the latter premised upon the knowledge that the marketplace usually denies us sure knowledge of what the plaintiff's position would have been absent the defendant's antitrust violation.

[77] Of course, even in the private arena, when damages are either unavailable or not the most effective remedy, equitable relief is sometimes available. *See* Areeda, Antitrust Violations Without Damage Recoveries, 89 Harv. L. Rev. 1127, 1139 (1976). *See also Berkey Photo, Inc. v. Eastman Kodak Co.,* 603 F.2d 263, 292–93 (2d Cir. 1979), *cert. denied,* 444 U.S. 1093 (1980), where plaintiff photofinisher sought only equitable relief for disadvantages stemming from Kodak's policy of selling only limited runs of color paper (a vital photofinishing supply) to its competitor-photofinisher. Kodak had a 60+% share of the color paper production market, but only 10% of the photofinishing market. The court quickly concluded: "given Kodak's monopoly power in color paper, this refusal to deal would, unless justified by a valid business reason, appear to violate §2 and form the basis for equitable relief." *Id.* at 292. The case was remanded for further findings on this issue but settled without findings.

that could not obtain vital supplies for independent power systems were injured by the ensuing lack of competition in power retailing.

Otter Tail relied upon *United States v. Terminal R.R. Ass'n,* 224 U.S. 383 (1912), which went even further: fear of potential injury to competition motivated the court's equitable decree. There was no showing that the Association had yet used its monopoly of approaches to St. Louis to impose discriminatory rates upon non-members; the court merely noted that the possibility was "inherent in the situation", "plain", "undeniable" and "obvious". 224 U.S. at 397, 400, 401, 405. [61]

In *Associated Press v. U.S.,* 326 U.S. 1 (1944), the By-Laws of the major U.S. news agency prohibited members from selling news to non-members and granted each member powers to block its non-member competitors from membership. The Court, without requiring any data on lost business,[78] held that the By-Laws obviously hindered and restrained the growth of competing news agencies and non-member newspapers:

> It is apparent that the exclusive right to publish news in a given field, furnished by AP and all of its members, gives many newspapers a competitive advantage over their rivals. Conversely, a newspaper without AP service is more than likely to be at a competitive disadvantage. 326 U.S. at 17–18.

In *Grand Calliou Packing Co.,* 65 F.T.C. 799 (1964), the fact that West Coast canners were injured by respondent's discriminatory leasing system was determined by the Commission on the basis of (1) calculating the cost differential between Gulf and West Coast canners and (2) accepting testimony of individual West Coast wholesalers and processors that they were losing money trying to match the Gulf Coast prices, but could have matched these prices had their lease terms been equal. 65 F.T.C. at 835–36, 841–845. The opinion did not utilize statistical comparisons of the overall growth of West and Gulf Coast canners as a class. In affirming *La Peyre,* the Fifth Circuit was even more spartan in its determination of competitive injury, relying wholly upon the rental rate differential. *La Peyre v. F.T.C.,* 366 F.2d 117, 120 (5th Cir. 1966). [62]

In our recent decision in *Reuben Donnelley,* continuing injury to the commuter and connecting carriers as a class was premised upon an inference of lost business,[79] rather than proof of the exact

[78] Indeed the Court gave only one "illustration" of how the By-Laws worked to block new entry and growth by non-member competitive newspapers, noting that in 26 cities of the U.S. existing newspapers already had contracts for AP news and had contracts with rival news services which severely limited any new paper's access to the news. 326 U.S. at 13.

[79] [S]eventy percent of commuter carriers passengers are connecting to or from certificated carriers. Thus the failure to list connecting flight information for commuter carriers deprived them of a primary marketing tool with respect to a large portion of their business. 95 F.T.C. at 55.

(Continued)

amount lost, down to the last decimal point. *In re The Reuben H. Donnelley Corp.,* 95 F.T.C. 1 (1980), *rev'd on other grounds,* 630 F.2d 920 (2d Cir. 1980).[80]

Finally, even in the private action of *Gamco, Inc. v. Providence Fruit & Produce Bldg., Inc.,* 194 F.2d 484 (1st Cir. 1952), the fact of plaintiff's exclusion from business opportunities associated with the best-situated market in town, without more, was enough to impell the Court to order that equitable relief be awarded on remand. 194 F.2d at 489. *See also Zenith Radio Corp., supra,* 395 U.S. at 132–133.

The conclusion is inescapable. Certain antitrust violations, usually those particularly susceptible of correction by government action, create a situation where the most effective relief is at equity, not law. When such cases involve an ongoing refusal to deal, harm to competition can be proven by testimony about the experience of representative members of the discriminated-against class of **[63]** competitors. Statistical surveys of the class' competitive strength, if closely related to the marketplace affected by respondent's actions, would be a welcome supplement. However, if the statistical proofs cannot be finely enough drawn, their absence is not fatal to the case. With this in mind, we review the statistical evidence available on the record.

A vast portion of this record is taken up with argument concerning the proper measure of the IBS' competitive strength. Their numbers, exits, sales, and profits are measured by means of at least five different data bases over various time spans[81] and compared with the same attributes of dealer body shops, "all service industries," or selected retail business, as the advocate's convenience dictates. In these comparisons, respondent attempts to show that the IBS are better off than assorted other businesses; complaint counsel of course attempts to prove the obverse. Generally speaking, respondent favors the numbers and sales data which show a growth trend in the overall class of IBS. Respondent argues that the increased numbers

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[M]ost users of the OAG read the listings of the flights between a city-pair from top to bottom and pick the first convenient flight; therefore, listing the flights of certificated carriers before the flights of noncertificated carriers often results in users picking a certificated flight without even looking at the listings for noncertificated carriers. 95 F.T.C. at 83.

[80] Indeed, the Second Circuit specifically endorsed the Commission's methodology of determining injury and the conclusions based thereon. 630 F.2d at 924–25.

[81] One quarrel which touches each set of statistics concerns the correct time period to examine. Generally speaking (for neither side scruples to be inconsistent for the sake of a momentary advantage), complaint counsel focus on the years 1972–1976 whereas respondent starts its trending in the mid-sixties. Nearly every measure shows the IBS entering upon leaner times in the early 1970's; respondent naturally wants to raise the average by adding in the more prosperous earlier years, while complaint counsel wants to cut those same years out, both to keep the picture as grim as possible and to avoid any implication that the IBS reached the natural limits of their growth before 1972. To us, both starting points seem equally capricious and dictated more by the choice of data base than any defined relationship to crash parts availability.

are a guarantee of increased competition. Complaint counsel rely more on exits and profitability data, which show that many individual IBS are unsteady competitors. Complaint counsel argue that competition must be assessed in terms of quality, not merely quantity.

(a) *Growth in Numbers*

There is no question but that, overall, the number of IBS increased between 1963 and 1977. Various subgroups of that class have been measured over various periods of time in that **[64]**fourteen-year span by four methods of varying accuracy.[82] The bottom line, however, is always growth—by at **[65]**least 40% over the 1967–1977 decade. At the same time, GM records show a slight decline (4.2%) in the estimated total number of dealer body shops. (RX 38)[83]

A simple comparison of growth rates, however, does not translate into an accurate comparison of competitive strength. There are too many different factors affecting the ease of growth for IBS and dealer body shops. The "independent" in the term Independent Body Shop is truly descriptive: and IBS can be started with a minimum of equipment and space and is often a one or two person enterprise.

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[82] (1) *Census Data:* The number of IBS (SIC Code 7531) reporting to the U.S. Census Bureau increased by 28.5% (4,621) between 1963 and 1967 and by 52.7% (10,982) between 1967 and 1972. (IDF 265, 266) No Census data are available for years after 1972, which curtails the usefulness of this set of statistics.

(2) *IRS Data:* This data is limited to IBS partnerships and proprietorships. It shows a numerical increase, in percentage terms, of 51% from 1967–1972. Between 1972 and 1976 the growth levels off abruptly, showing an incremental increase of only 2.9%; but this still provides a growth of 55.3% for the years 1967–1977, during which dealer body shops declined in number by 4.2%. (IDF 268) Since IBS corporations account for approximately 10% of the total number of IBS businesses (Nelson Tr. 13789, 13796), their exclusion probably does not skew this data unduly (it will be a different story on sales and profit trends derived from IRS data).

(3) *Telephone Directory Listings:* One of respondent's employees prepared a tabulation (RX 41) purporting to show the number of IBS in each of complaint counsel's selected trade areas (except Manfield, Ohio) for the years 1967, 1972 and 1977. The numbers were arrived at by the simple process of counting the listing under the "Automobile Body Repairing and Painting" heading in the classified ad section of the phone books for the greater metropolitan areas of each city, in each year. Although the ALJ seems to find that such surveys can be accurate (IDF 278) we conclude that this survey, at least, is riddled with methodological errors. For example, respondent made no attempt to verify that each listed company was actually in business, was engaged primarily in body work (as opposed to paint work, mechanical repairs or salvage work), or generally worked on GM vehicles (as opposed to foreign autos). (Stocker Tr. 11334–36, 11345–46, 11351–55, 11369, 11376–77). Even more serious is respondent's failure to see if the companies listed in the earlier phone books were still listed in the later years of the tabulation. By complaint counsel's calculations, fully 28%–45% of the companies listed in 1972 did not appear in the 1977 Yellow Pages. (CRF 167)

(4) *Dun and Bradstreet Data:* The number of IBS surveyed by D&B grew from 11,644 in 1972 to 17,864 in 1977 (+53%). Since D&B surveys only those body shops for which it has been requested to furnish a credit report (Barry Tr. 12141–145) this sample does not tell us anything about the overall growth in numbers of IBS, but merely pictures the rise in numbers of IBS whose credit rating was of interest to a D&B client.

[83] The GM franchise agreement requires dealers to submit a Trial Balance Form (Financial Statement) containing a variety of accounting data to the Dealer Business Management Department; about 90% of the dealers do so. (Vasquez Tr. 11410–13, 11432) The Trial Balance Form shows sales from the body shop and thus how many of the reporting dealerships have body shops. Of the 10% who did not report, GM estimated that the percentage of nonreporting dealers with body shops exactly corresponded to the percentage of reporting dealers with body shops. (Vasquez Tr. 11433-34) Complaint counsel claims this "blowup" method of determining the universe of DBS is unreliable, but we think a 10% or less error is acceptable in this context. We note that we sanctioned "blowup" methodology in *Retail Credit Co.*, 92 F.T.C. 131, 140 (1978).

(IDF 264) By contrast, a dealer body shop is always an adjunct of a GM car franchise,[84] and establishing a car dealership involves capital outlay, personnel commitment and other requirements — not the least of which is filling a need in GM's automobile marketing plan — unknown to the independents. The numbers indicate only, therefore, that entry into the independent body shops business is perceived as desirable and is relatively easy; they tell nothing of the level of competition offered once the low entry barriers are breached or the ability of individual IBS to stay in the business they so easily entered. For these purposes we must look to the statistics on exits. **[66]**

(b) *Exits*

Respondent maintains that IBS have a low failure rate in contrast to many other retail lines of business, relying on Dun and Bradstreet reports which state that the IBS failure rate has declined from 32 per 10,000 in 1972 to 15 per 10,000 in 1977. (RX 303B) This represents the next-to-lowest failure rate for any of the twenty-three retail lines of business for which D&B keeps failure rates. (RX 303A) However, the D&B reports are so flawed as to IBS that cross-industry comparisons, even if valid,[85] are impossible. As noted in note 82, *supra* p. 64, the D&B universe of IBS is not representative of the overall IBS universe. Moreover D&B's definition of "failure" is too limited: It excludes all firms which cease business but leave no unpaid bills, *e.g.,* IBS which operate on a C.O.D. basis, or which simply become discouraged at continuing low profits and wind up the business honorably. Finally, D&B's collection of failure information misses all personal bankruptcies, a course of action open to the 90% of IBS which are proprietorships. (Nelson Tr. 13774–75; Wyant Tr. 12236–41)

In contrast, complaint counsel's statistics, based upon Census data for 1972 seem fairly reliable. They show a failure rate of 1,140 per 10,000, the fifth highest of the 24 retail lines of business. The Census universe is more truly comprehensive, as is its definition of exit from business.[86] While the cross-industry failure rate comparison remain as tenuous under Census-based calculations as under D&B statistics,

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[84] Significantly, the 1967–1977 decline in dealer body shops is slightly outpaced by a decline in dealerships (RX 38), indicating that the decline in dealer body shops may be the result of overall franchise matters, rather than competition in body work.

[85] The free-floating variables which complicate comparisons between IBS and dealer body shops are even more numerous when comparing IBS to "Department Stores" or "Lumber & Building Materials"—and the nexus to crash parts is even more tenuous.

[86] The Census Survey of Selected Service Industries publishes the number of business which were in business during the year but have ceased business by the end of the year. The exit data (*i.e.,* "are you in business" is requested by the survey form, which must be answered under oath. (Nelson Tr. 13765–67) The form of the question may lead to a slight overstatement of failure rate, as it picks up IBS discontinuences for other than total failure,

(Continued)

and for the same reasons, the Census figures do have limited uses. First, the Census data [67]casts further doubt on the reliability of D&B statistics. Second, for one year at least it corroborates the IBS witnesses' testimony about their difficulty surviving. The necessary link between crash parts and business failures is provided by that same testimony, which shows that the cost of crash parts is a crucial variable in a body shop's profit picture.

(c) *Sales*

The record contains a welter of fragmented sales statistics for dealer body shops and IBS in three distinct time periods between 1963 and 1977. Owing to the use of three disparate data bases, only for 1967–1972 do we have data covering the complete universe of IBS and dealer body shops.[87] That data shows that aggregate sales of IBS increased by 116% while aggregate sales of dealer body shops increased by only 40%–48%.[88] [68]

The fact that IBS aggregate gross sales increased at over twice the pace of dealer body shop sales does suggests that the IBS are strong competitors in repair of crash-damaged GM vehicles. However, it is important to note that "sales" includes, for the IBS especially, far more than auto collision repair work: as described more fully under the "Profitability" subheading, *infra,* over the years, due in part to inability to compete in body work, the IBS have diversified into other lines of repair work. A significant, though unquantifiable portion of the IBS increased volume of business is generated by these sideline operations. (IDF 282)

(d) *Profitability*

The record does not permit any comparisons of IBS and dealer body shop profitability,[89] since it lacks any information on dealer

notably change in legal form of the organization (*i.e.,* from a partnership or proprietorship to a corporation). However, since only 10% of IBS are corporations (Nelson Tr. 13796) we are inclined to think the bias is slight.

[87] For 1963–1967 we have Census data on the aggregate sales of both IBS partnerships and proprietorships and IBS corporations (*i.e.,* the complete universe of IBS) (IDF 269), but no data on dealer body shop sales. For 1967–72, we have GM estimates on its dealer body shops' aggregate sales (IDF 270) and both Census data on all IBS sales (IDF 270) and IRS data on aggregate sales of IBS proprietorships and partnerships (*i.e.,* IBS corporations excluded). (CX 7818–7819) For 1972–1977 we continue to have GM's estimates on aggregate sales by dealer body shops (RX 322) and IRS data on aggregate sales by IBS proprietorships and partnerships (CX 7818–7819), but the lack of continuing Census data means there is no direct proof of corporate IBS sales. The question of whether such proof can be reached by an estimating process known as 'linking' was battled hotly throughout the trial and appeal. (*See* IDF 272–273) Since we conclude that the gross sales figures are not sufficiently focussed on crash parts to be of use in this analysis, we do not need to consider the issue. We do note however, that even under the incomplete set of data most favorable to complaint counsel, the growth in IBS sales volume for 1972–76 was only minutely less than growth in dealer body shop sales (IBS partnerships and proprietorships: up 37.1%; dealer body shops: up 37.9%). (CX 7819)

[88] Complaint counsel argue that GM's estimates on dealer body shop sales are understated by 20% because five categories of dealer body shop revenues were systematically excluded. (CRF 157–161) Even if this 20% is factored back in, however, the contrast between IBS and dealer body shop aggregate sales growth is still great.

[89] Once again, we resist the invitation—this time respondent's—to use these statistics to make cross-industry

(Continued)

body shop profits. IBS partnership and proprietorship earnings as reported to the IRS for 1967–76 are summed up at CX 7818–20. The data is, like the other IRS statistics, incomplete, as it does not include IBS corporations. This definitely skews the low profit averages which complaint counsel draw, since IBS corporations, being generally the largest, most profitable IBS businesses, produce about 32% of total IBS business receipts. (Nelson, Tr. 14301) Nevertheless, since IBS corporations represent only about 10% of IBS businesses by number, the IRS statistics are accurate as to approximately 34,561 IBS partnerships and proprietorships (1976 figures - CX 7819; 7820) **[69]**—a subgroup of no little size. As a class, non-corporate IBS did fairly well from 1967–72 with aggregate net income increasing by 54%. (RX 314A) (We have already noted the increase in IBS sales during this period.) However, in the years 1972–76 non-corporate IBS aggregate net income increased by only 3.3%, while the percentage of non–corporate IBS losing money jumped from 7.2% in 1967 to 19.9% in 1976. (Derived from RX 315B; RX 320) On a per shop basis and in stark dollar terms this means that the average net income of an IBS proprietorship/partnership was $5,256 in 1967—and only $5,410 nine years later. With the consumer price index for all services increasing by 180.4% during those nine years, these IBS needed to be making $9,482 in 1976 just to stay even in real income with their 1967 earnings. (CX 7820)

The profitability statististics are derived from IRS Schedule C, a form which is filed to obtain a variety of deductions allowed in the tax code. Accordingly, Schedule C filers have an incentive to overstate expenses and, possibly, understate revenues on the form; such inaccuracies would be reflected in the aggregate numbers. (Bentson Tr. 15841–43) Respondent's expert was unable to quantify or even guess at the extent of this bias. (*Id.*)

On the other hand, the record contains testimony which supports the inference drawn from these statistics: that many IBS have faced decreasing profits in more recent years. Witnesses observed that IBS owners often cut corners by paying themselves low salaries,[90] working extraordinarily long hours, and employing their families at little or no remuneration. (IDF 280; CPF 155, 161, 176–179) Even so, many of the IBS witnesses from the seven trade areas, testifying as

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comparisons—here of IBS with General Auto Repair Shops. (RAAB 21) General Auto Repair Shops specialize in electrical and mechanical work, for which no crash parts are required and for which parts are readily available from a multitude of suppliers. General Auto Repair Shops (GARS) are analogous to dealers' mechanical shops, not dealer body shops. (Nelson Tr. 15224–26, 14390–91)

[90] *See, e.g.*, Daniels Tr. 2292, 2293: yearly salary of $17,000 over a number of years for 60-65 hours of work a week; Lakatos Tr. 4010–11: yearly salary of approximately $15,000 during 1972–1976. Similarly, former IBS owner Edward Serwacki observed (Tr. 4841–42, 4859) owners of "many newer shops" working "all kinds of hours" for $100–$150 a week in order to stay in business. (Serwacki Tr. 4841–42, 4859)

to the years 1976–1977, told of experiencing losses or significant decrease in profits. Moreover, some portion of the small profits [70] which these IBS were able to eke out comes from increasing diversification into non-crash work such as towing, office furniture and cabinet repair, mechanical and radiator repair, frame straightening, customizing and specialized (non-car) collision repair. (IDF 281–283) IBS are doing less work on GM vehicles, as a percentage of total business, than formally (IDF 247, 282) Even as to the GM work remaining, some is sublet work from dealers. (IDF 284)

(e) *Conclusion*

Our conclusion, after a careful examination of the statistics in this record is that the parties have pretty much battled to a stand off. None of the four proposed measures of competition performance allows us to make direct comparisons between IBS and dealer body shops: the difference between a body shop dedicated solely to repair work and one which is part of a new car selling operation introduces too many variables into comparisons in terms of growth in numbers and profits and exits; also, the uncertainty of what products are included in sales records obscures that comparison. Moreover, both complaint counsel's and respondent's chosen data bases suffer the same fundamental flaw with regard to the focus of this case. Each yields some inference about the competitive vitality of GM dealerships or the IBS, but in no case is there a measurable correlation between the availability of crash parts and the overall competitive condition shown.

The most we can use these data for is to examine the IBS' competitive health, standing alone. Here we think that the statistics on failure rates and profits for non-corporate IBS enlarge on the testimony about individual IBS' difficulties in maintaining their businesses. The data therefore confirm that the seven trade areas are fairly representative of national trends. When these data are read with the testimony and document described earlier it becomes apparent that a major cause of this IBS weakness is the fact that they pay, on the average, 17.7% more for GM crash parts than their competitors, the dealer-installers. On the other hand, respondent's statistics on overall growth of IBS open up a dimension which was only hinted at in the testimony: the fact that, if exits are common in the IBS business, entry is even more so, and that, in the aggregate, IBS have shown a significant net growth in the last decade.

In short, the record in this proceeding does not establish a clear and direct link between GM's selective distribution policy for crash parts and any weakness of the IBS, as a class. It is clear, at the same

time, that in general IBS are at a substantial competitive disadvantage with GM dealer-installers, [71]due to the near impossibility of the IBS overcoming or otherwise compensating for their significant price disadvantage on GM crash parts. It is also clear that on any local basis the shifting crowd of IBS is generally powerless to shake the stabilized GM dealer's position in auto body repair work, which is buttressed by favorable prices on crash parts. Overall, we believe the IBS are competitively injured by GM's distribution system and that legally that injury meets, if barely, the required showing of substantial injury to competition.

4. Substantial Business Justification

General Motors argues that there are two reasons to resist change in its selective distribution system for crash parts: *i.e.,* the system encourages new car sales and the system would be extremely costly to revise. The second argument is particularly persuasive.

The relationship of selectively distributed crash parts to new car sales is tenuous. We note that GM has not made the argument that its selective distribution for sole source parts is designed to ensure that crash parts get into the hands of only qualified installers. There are no product quality or safety issues here. *Cf. United States v. Bausch & Lomb Optical Co.,* 321 U.S. 707, 728–729 (1944); *Tripoli Co. v. Wella Corp.,* 425 F. 2d 932 (3rd Cir. 1970). Crash parts are not items which require much special knowledge to install, and the record contains no suggestion that the IBS do not do at least as good a job as the dealer-installers. Nor is a crash parts "exclusive" required to reward a dealership for expanding its promotional efforts in order to stimulate demand for crash parts. These items are not the sort of new or complex product for which the consumer has to be wooed into spending discretionary dollars. *Cf. Sandura Co. v. FTC,* 339 F.2d 847 (6th Cir. 1964).

GM argues generally, however, that by selling crash parts exclusively to its dealers it ensures their loyalty to GM and their increased efforts in selling new cars. A common sense evaluation of the relative importance of crash part sales *vis-a-vis* new car sales in a dealership's profit picture supports the ALJ's findings that a dealer has sufficient incentive to sell GM's new cars without the extra inducement to loyalty of a crash parts monopoly, and that GM's crash parts policies do not add significantly to that incentive. (IDF 58, 390) Moreover, GM produced no testimony or documentary evidence to show that it is having trouble attracting competent dealers, and can only persuade them to take on a franchise by adding the inducement of a crash parts exclusive. [72]

On the other hand, GM is probably correct in its claim that a consumer's decision to buy a new car, particularly on repeat purchases, is influenced by the consumer's perception that crash parts will be widely available should the car ever need body repair work.

Availability must be distinguished from cost. Consumers look to their insurers to pay accident repair costs (CX 7815P) and rarely, if ever, inquire about cost of crash parts when negotiating the purchase of a new car. (*See, e.g.,* the testimony of dealers Bogard, Tr. 10564–65; Durbin, Tr. 1382; Shaeffer, Tr. 10729–30) Consequently the wholesale cost disparity between dealer-installers and IBS is probably unknown to consumers. In determining which car a consumer selects, such factors as car styling, car price, gas mileage, car resale value and even the reliability of engine parts assume a greater importance than the cost of crash parts. (Sutliff Tr. 11068–71) We are convinced that most consumers are unaware of their dealer's priority rights to crash parts, and so few, if any, new car buying decisions are influenced by that aspect of GM's crash parts distribution system.

However, whether GM's distribution system assures general availability of crash parts does concern the consumer. And here, at first glance, it seems that GM could only benefit by getting crash parts into the hands of IBS as quickly as possible and at non-discriminatory costs. The IBS could handle a large percentage of GM vehicle crash repairs. If there is any validity to the argument that unavailable crash parts would cause a car owner to switch to another make of vehicle the next time, then it is reasonable to conclude that the same buyer will be unhappy if she or he experiences delay in getting the car repaired by an IBS.

This leads us to GM's second line of argument. It concerns the risks of change. In our analysis of this question we have relied considerably upon the testimony of Paul R. Murphy, comptroller and principal financial officer of General Motors Parts Division (GMPD). Starting with the proposition that GM's goals are to distribute crash parts efficiently and to gain consumer goodwill with easy availability of crash parts, Mr. Murphy emphasizes that "the system works" in achieving those goals. (Tr. 10069, 10071) Although GM's distribution system for crash parts is selective, it extends to a nationwide [73] network of dealerships, and would produce a reasonable degree of availability even if none of the dealers wholesaled crash parts on the side. (IDF 116; Murphy Tr. 10077) Availability is of course improved when dealers wholesale, and GM from past experience can expect

between 20% and 40% of its dealerships to redistribute crash parts.[91]

As we noted before, we do not think that this level of availability is the highest possible: inclusion of IBS in the direct GM distribution system might improve it. However, there would be significant costs associated with opening up the system.

GM's present customers for crash parts, the dealers, are also customers for the other 265,000 sole source parts which GMPD distributes. (IDF 159, 167) These other parts are not much described in the record but appear to include chassis parts, interior trim parts and engine parts, most of which, like crash parts, are uniquely configured to the various GM cars. (IDF 165; Murphy Tr. 10177–81) GMPD makes no distinction between crash parts and all other parts required for servicing a GM vehicle. (IDF 167) When GMPD was set up to provide centralized parts supply to the dealers, inclusion of crash parts within its distribution system was both logical and efficient. Also, the fact that these crash parts customers have an ongoing business relationship with GM for the purchase of parts, not to mention new cars, means that GM has significant leverage in exacting prompt payment for crash parts. GM would not have that leverage with the IBS. If the system were opened, GM would undoubtedly face a significant administrative burden in checking the creditworthiness of and attempting to collect payments from a potentially vast number [74]of new customers. Other costs could be expected, chiefly those associated with handling more and smaller orders. Not only are the IBS generally smaller operations than dealerships, which leads us to expect smaller order size from them, but the size of dealership orders would also shrink, as dealers let GM take back all or a portion of their wholesaling function. When the order size decreases, the cost per ordered item increases. As Mr. Murphy put it, "just almost every thing in the entire process is going to . . . require more resources." (Murphy Tr. 10079; Bentson Tr.

[91] GM has no records from which one can compute precisely how many GM dealers wholesale parts, much less how many routinely stock parts in amounts greater than their own body shop needs and still less how many of these parts are crash parts. (Murphy Tr. 10293) GMPD comptroller Paul Murphy estimated that 40% of GM's dealers are "active" wholesalers. (Murphy Tr. 10074) However, as Mr. Murphy did not quantify what he meant by active wholesaling, and as an internal GM document indicates that it takes a yearly $500,000 parts volume to engage in significant wholesaling (CX 7254S), we agree with both complaint counsel's and respondent's expert witnesses that a yearly volume of $100,000 or more in parts sales indicates meaningful wholesaling efforts. (Nelson Tr. 15148; Benston Tr. 16104) Using the $100,000 annual sales cut off point, in 1976 approximately 22% of all GM dealers accounted for approximately 80% of all dealer wholesale sales of parts. (RX 30) GM has no data, nor does the record contain data from other sources which shows how many dealers stock crash parts, or the degree to which they stock. (Murphy Tr. 10294)

15811, 15829–30) Unfortunately, the only estimate of the extent of these added distribution costs seems to us to be inflated.[92] Nevertheless, we recognize that such costs would not be insignificant and to some degree would occur on a continuing basis. We also note that other car manufacturers, who presumably have the same incentives as GM for finding the most efficient crash parts distribution system, all use systems similar to GM's. (IDF 94)

This situation, therefore, presents a more difficult balance than we faced in *Donnelley.* In *Donnelley* we stated, "In examining the question of business justifications, the economic self interest of the monopolist would be the major but not the exclusive consideration. Where there is little justification for a business policy, the antitrust laws can require that the monopolist take into account the effect on competition of its actions in the line of commerce made up of [those] wishing to deal with it." 95 F.T.C. at 82. In that case respondent offered "no explanation whatsoever" for its refusal to deal. *Id.* Moreover, it knew that rescinding its refusal (to list commuter connecting flights) would cost only $6000, and when the actual change in policy occurred it was accomplished "with apparent ease and no ill effects." *Id.* Commissioner Pertschuk seems to suggest that since transaction costs will always be associated with imposition of a duty to deal, they should be given small weight as a business justification. We disagree. *De minimis* or speculative transactions costs will be given small weight, but reasonable projections of significant changeover costs must be heeded. In this case GM has shown that a course of selective dealing gives it satisfactory market penetration with as lean a distribution system as possible. It has also shown that sizeable costs would accompany an expansion of the system, without any [75]offsetting gain to GM.[93] Certainly if system-wide distribution costs were to increase, consumers would soon face higher repair costs on crash-damaged vehicles.

Finally, we are concerned that any order restructuring GM's distribution system would involve the Commission in ongoing supervision of the system. For example, since we found injury to competition only at the installation level of competition, our order would not require that GM deal with all potential customers, but merely deal on equal terms with all crash parts installers. However

[92] Mr. Murphy, without elaboration, stated it would cost GMPD $40 million more annually to handle an additional 10,000 customers. (Tr. 10079) This amounts to $4000 per customer, which seems high, given that GMPD's warehouse system is fully computerized. (Murphy Tr. 10090–97).

[93] It must be remembered that, owing to the static demand for crash parts, a change in distribution systems will not significantly increase the actual number of parts GM sells in any year. Of course there could be a shift in inventory from the dealers who are now wholesaling back to GMPD, and GM could raise the warehouse price of crash parts to cover its increased wholesaling costs, but this would be a reallocation of existing expenses and profits rather than any real gain to GM.

it would be difficult to arrive at a clear definition of "crash parts installer" for purposes of the order: would it include an IW who opened a small body shop adjacent to its warehouse? We foresee that we would have to commit extensive resources to reviewing GM's interpretations of to whom and at what price it should sell crash parts.

In sum, although there is a troubling degree of injury to competition shown in this case, a reasonable degree of business rationale for the situation has also been shown. On balance, while we are not convinced by this record that GM would be burdened to the extent it has argued by opening its warehouses to IBS, we cannot say that its refusal to do so is arbitrary and without business justification.

III. PROCEDURAL ISSUES

A. *Noerr-Pennington*

Having decided that GM and NADA did not engage in a combination to restrain trade, we need not reach the question, raised by respondent in its appeal, of whether the *Noerr-Pennington* doctrine protects the efforts of GM or its dealers to get the FTC to settle the crash parts controversy. **[76]**

B. Struck Testimony

By "Order Modifying Order Granting Motion of General Motors Corporation for Production of Interview Reports" dated October 31, 1978, the ALJ ordered the testimony of four GM witnesses struck from the record, because GM's counsel refused to give complaint counsel written reports of pre-trial interviews with Arthur H. Cann, parts manager of Courtesy Chevrolet in San Jose, California; Joan Mack, parts manager of Tom Parsell Chevrolet in Charleston, South Carolina; David W. Vulbrook of the National Association of Independent Insurers from Des Plaines, Illinois; and Henry Faulkner, an Oldsmobile dealer from Philadelphia, Pennsylvania. These reports were all made by GM attorneys. GM objects to the striking of the testimony on three grounds. First, GM claims that the obligation to turn over interview reports derives from the Jencks Act, which imposes such an obligation on complaint counsel but not on a respondent. Secondly, GM argues that absent such obligation, a respondent's interview reports are "attorney work product" which are privileged from disclosure unless some extraordinary need is shown. Such extraordinary need, GM claims, has not been established. Lastly, GM states that the struck testimony was "materially

responsive to the assertions of complaint counsel in this proceeding" and its striking was, therefore, prejudicial to respondent. (RAB 27–30) Complaint counsel reply first, that substantial authority as well as fairness compels the adoption of a policy which requires both sides to produce relevant, previously recorded statements of witnesses. Secondly, complaint counsel argue that these reports are verbatim witness statements and so are not shielded by the attorney work product doctrine. Finally, complaint counsel deny that GM has suffered any prejudicial injury from the ALJ's action, and argue that even if it did, such injury would be entirely proper in order to prevent a partial view of issues. (CAAB 59)

1. Procedural History

Respondent started an avalanche of motions and orders on this subject by a small snowball, requesting copies of complaint counsel's witnesses, to be delivered one week before the witnesses were scheduled to testify. In response to this motion the ALJ ordered *both* sides to exchange witness interview reports in advance of scheduled testimony. (Order Granting Motion of General Motors Corporation for Production of Interview Reports, April 10, 1978, hereinafter Order of April 10, 1978). Complaint counsel moved for reconsideration, on the grounds that interview reports are producable only after testimony, but the ALJ denied this motion and reaffirmed the Order of April 10, 1978. Making the best of, in their opinion, a bad business, complaint counsel then moved for production of respondent's interview reports. Counsel for GM replied that he had nothing in his files that was not exempted from disclosure by either the attorney-client priviledge or the attorney work product doctrine. [77]

Matters came to a head at a hearing on September 27, 1978, where the ALJ reviewed reports respondent was withholding, which related interviews with the four witnesses named above. After literally blue penciling out certain portions which he deemed attorney work product, the ALJ ordered that the remainder of the reports be produced for complaint counsel forthwith. This counsel for GM continued to decline to do. Complaint counsel thereafter moved to strike the testimony of the four witnesses, although subsequently entered into a stipulation that the testimony of Cann, Mark and Faulkner could stand. (It appears that complaint counsel were actually present at respondent's counsel's interviews with these witnesses.) The ALJ decided, nevertheless, that the better course would be to apply the sanction to all four witnesses, and so ordered on October 31, 1978.

2. Applicability of Jencks Act Procedures

A "Jencks Act" statement is defined, 18 U.S.C. 3500(e), as a written pretrial statement made by a witness for the United States and signed or otherwise adopted or approved by the witness; or a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital of an oral pretrial statement made by such a witness and recorded contemporaneously with the making of the oral statement. (Statements made to grand juries are also included but not relevant here.) The Jencks Act proper applies only to criminal prosecutions. We have held, however, as a matter of our discretion, that its principle should be applied in Commission proceedings to require production of certain prior statements by complaint counsel's witnesses after they have testified. See *US Life Credit Corp.,* 91 F.T.C. 984, 1037 (1978), and cases cited therein. Complaint counsel now urge that we apply the Jencks Act principle to *respondent's* witnesses to uphold the ALJ's action in striking the testimony at issue here. We decline to do so for the reasons set forth below.

At the outset, we wish to make clear to both counsel and the administrative law judges that our reliance on the Jencks Act "principle" rather than the Act itself (whose limitation to criminal cases we have already noted) is not an invitation to ignore the other salutary limitations incorporated in the Act to protect the principle's integrity. In particular, we reiterate that (1) the safeguards of the accuracy of the statement (*i.e.,* the requirement that the witness have unequivocally [78]adopted it or that it be substantially verbatim and complete) must be strictly observed, *US Life, supra;* and (2) production will be required only *after* the witness has testified,[94] *Interstate Builders, Inc.,* 69 F.T.C. 1152, 1165–67 (1966).

So far as appears from the record before us, neither of these limitations was honored in the series of rulings which led up to the striking of the testimony at issue.[95] However, although the point is

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[94] As we indicated in *Interstate Builders,* this procedure is designed to protect against a chilling effect on the willingness of persons with information useful to law enforcement to make statements in the course of an investigation although they might not be willing to testify at trial, and considers the limited purpose of the Jencks Act, *i.e.,* enabling the defendant/respondent to make use of a prior inconsistent statement in conducting cross-examination. The Act has never been intended as a tool of discovery, since a respondent is free to conduct his own interviews of potential or planned witnesses.

[95] See our discussion in *US Life,* 91 F.T.C. at 1038–39, of the rigorous tests which must be applied to qualify statements either as adopted by the witnesses or as substantially verbatim recitals, in particular our observation, quoting from *Palermo v. United States,* 360 U.S. 343, 352 (1959), that "the legislation was designed to eliminate the danger of distortion and misrepresentation inherent in a report which merely selects portions, albeit accurately, from a lengthy oral recital."

not entirely free of ambiguity[96] it appears that the ALJ disclaimed reliance on or limitation by the Jencks principle in the rulings under consideration.[97] In [79]these circumstances we need not and do not decide whether the application of the Jencks Act principle can or should include prior statements by respondent's witnesses as well as those of complaint counsel.[98] What we must decide is whether the ALJ's order has some sufficient basis other than the Jencks Act principle.

3. Attorney Work Product

As we said in *Interstate Builders, supra,* 69 F.T.C. at 1172, "[i]n view of the limited nature of the Jencks rule, it is clear that the policy considerations underlying the work product rule which were so emphatically stressed by the Supreme Court in *Hickman v. Taylor* [329 U.S. 495 (1947)] are still operative whenever Jencks statements are not involved."

In the seminal case of *Hickman v. Taylor,* the Supreme Court granted qualified immunity from discovery to an attorney's work product described as private memoranda, written statements of witnesses, and mental impressions or personal recollections prepared by an attorney in contemplation of possible litigation. From the onset, the Supreme Court, and the Commission likewise, have recognized that the work product rule is not absolute but may yield on a showing of substantial need. *Hickman v. Taylor, supra,* 329 U.S. at 509; *see, e.g., Warner-Lambert Company,* 83 F.T.C. 485 (1973); *Graber Manufacturing Company, Inc.,* 68 F.T.C. 1235 (1965). In both F.T.C. cases, the Commission emphasized that before respondent could receive documents considered to be the attorney's work

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[96] The ALJ's Order Denying Motion For Reconsideration Of Order Granting Motion of General Motors Corporation For Production of Interview Reports, April 20, 1978, speaks in terms of requiring complaint counsel to "hand over Jencks statements," and involved the ALJ's initial decision on this subject in *US Life* (subsequently overturned in this respect by the Commission in the passage cited above).

[97] In his Order Denying Motion For Reconsideration Of Order Of September 27, 1978, Requiring the Production of Interview Reports, dated October 13, 1978, the ALJ asserted that "my Order is neither predicated on the Jencks Act nor on the Commission's expressions regarding its adoption of the principles inherent in Jencks." He added that while statements covered by the Act would clearly be included in the larger class of statements subject to the order, that order "need not be and was not intended to be limited to Jencks Act principles."

[98] In *US Life, supra,* 91 F.T.C. at 1037 n. 34, we observed that we had not theretofore been called upon to resolve that issue, simply noting the Supreme Court's decision in *United States v. Nobles,* 422 U.S. 225 (1975). Complaint counsel urged reliance on that case here. We observe, however, that in that criminal prosecution the proof substantially consisted of two eyewitness identifications of Nobles, that the statements at issue which purportedly undermined the witnesses' credibility had been taken by a defense investigator whom defense counsel sought to put on the stand to testify to the substance of the statements, and that the decision seems to have turned on the proposition that this attempt waived any work-product privilege which attached to the statements. 422 U.S. at 236–240.

product, strong showing of special circumstances, good cause or necessity must be demonstrated.[99] [80]

The work-product rule has now been formally incorporated in the Commission's rules governing discovery, at Section 3.31(b)(3). Although the Commission rule did not become effective until after the issuance of the rulings in question, it is nonetheless expressive of the work-product rule as derived from *Hickman* and as expressed since 1970 at Rule 26(b)(3) of the Federal Rules of Civil Procedure. As such, it embodies the principles appropriate for application to the present question. Rule 3.31(b)(3) provides in pertinent part that:

> a party may obtain discovery of documents . . . otherwise discoverable under subdivision (b)(1) of the rule and prepared in anticipation of litigation or for hearing by or for another party or by or for that other party's representative (including his attorney, consultant, or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the Administrative Law Judge shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party.

First, there seems to be no question that the witness statements or interview reports or attorneys' notes in question are within the class of documents "prepared in anticipation of litigation" and covered by this section and the case-law doctrine. Indeed, the *Hickman* decision itself concerned just such pretrial statements or reports. Second, it must be noted that the rule (and the doctrine) apply what might be characterized as two layers of protection. Any document which falls within the coverage of the section is to be ordered produced only upon a showing of "substantial need" and "undue hardship." It is only when that showing has been made that the further admonition to "protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party" comes into play. Thus, the task of an administrative law judge faced with a request to compel production of work product or hearing preparation materials consists of more than simply excising mental impressions, etc., and turning over the residue. The ALJ must first consider whether substantial need for the materials has been demonstrated, which need cannot be substantially met from other sources without undue hardship. *See* Order Upon Application for Interlocutory Review, *In re The Gillette Co.,* FTC Docket No. 9152 (December 1, 1981) [98 F.T.C. 875]. [81]

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[99] The fact that both *Warner-Lambert Company* and *Graber* concerned the work product of complaint counsel does not diminish their precedential value in view of our endorsement of the principle of even-handedness in discovery. *Allstate Industries,* 72 F.T.C. 1020 (1967).

In the present case, this analysis does not appear to have been carried out. Rather, the ALJ essentially grounded his rulings on his view that Commission precedent requires that "each side should maximally provide the other with information as to the positions each will take and the evidence each will use to prove its case." Order of October 13, 1978, *supra*. While we have no quarrel with this statement as a characterization of the policy underlying our discovery rules and practice, it must obviously be qualified in practical application by reference to those rules and to our rulings in such cases as *US Life* and *Interstate Builders*. Further, we note that the relationship between this stated principle and the specific disclosure ordered by the ALJ here is not clearcut; that is, disclosure of witnesses' prior statements is not especially well-targeted to reveal a party's "position" or "the evidence [it] will use to prove its case." Other devices, far less intrusive and better aimed, are available to serve these purposes. The only end which disclosure of such statements can uniquely serve is that of cross-examination, and only then when the safeguards of the Jencks Act principle are observed.

We are constrained to conclude that the ALJ's disclosure rulings upon which he based his order to strike testimony were not properly grounded either on the Jencks Act principle or on a due consideration of the work-product doctrine. We are not of a mind to search the record in an attempt to determine if the orders might have been justifiable upon proper analysis, particularly in view of the fact that complaint counsel themselves stipulated that the testimony of three of the four witnesses need not be struck, and gave no compelling reason why they needed to see interview reports for the fourth. Under the circumstances, we believe that the ends of justice are best served by reinstating the testimony of the four witnesses and considering it in reaching our decision on the merits, and we have done so. Thus, respondent has not been prejudiced by the ALJ's Order of October 31, 1978, or the series of orders which led up to it.

DISSENTING STATEMENT OF COMMISSIONER PERTSCHUK

I dissent from my fellow Commissioners' decision to dismiss the complaint in this matter. I would have found liability on the part of General Motors for a violation of Section 5 and would have voted to issue an order requiring GM to deal on non-discriminatory terms with independent body shops.[1]

[1] Any order to GM to deal on a non-discriminatory basis would have to include certain qualifications. First, I agree with the majority that GM has no duty to deal with independent wholesalers directly since it has chosen to assume the "first tier" wholesaling function itself and there is no duty on the part of a monopolist under the theory

(Continued)

As I understand the majority's opinion, the Commission does not retreat from the position it took in *Reuben Donnelley,*[2] where we stated that a monopolist has a duty to deal fairly under certain circumstances with those seeking to deal with it. Nor does the Commission fail to find adequate harm to competition to constitute a violation. To the contrary, the majority concludes that there is "a troubling degree of injury to competition shown in this case." (Majority op. at 75) The Commission chooses to dismiss the complaint, however, on the basis that there is adequate business justification for GM's refusal to deal with independent body shops. I disagree with this conclusion. [2]

In assessing GM's argued justification, it is useful to review the standard set out in *Reuben Donnelley* for an adequate business justification for refusing to deal with certain classes of customers. There the Commission stated that a duty to deal arises only if a failure to do so results "in a substantial injury to competition and lacks *substantial* business justification."[3] (emphasis added) Thus, we are not concerned with only minimal or speculative harm to competition, but, in the event that substantial harm is found, the justification, similarly, must not be minimal or speculative, but must be substantial. Moreover, the burden of proof on this issue is the respondent's.

The injury to competition from GM's refusal to sell crash parts to independent body shops is that these suppliers of repair services are disadvantaged in competing with GM dealers because they must pay substantially greater costs for parts than their dealer competitors. A part of this differential is theoretically accounted for by the second level "wholesaling " function of dealers—ordering and storing parts. The only record evidence of the costs of ordering parts is that it constitutes 2% of the dealers' sales price. (Majority op. at 52, fn. 67) The record is silent on the percentage of dealers who store parts in large quantities, either for their own use or for resale to others. Many dealers, who receive the maximum discount, apparently order crash parts only on an "as needed" basis, however.

The "premium" paid by independents, that is, the price paid for crash parts over and above the price paid by dealers, amounted to $41.6 million in 1977.[4] If the 2% cost attributed to the wholesaling

of *Reuben Donnelley* to create rivals to itself. (Majority op. at 43) In addition, there are legitimate reasons for GM to refuse to deal with any customer under particular circumstance, including high risks of granting credit, poor payment histories, etc., which would have to be acknowledged exceptions to a duty to deal requirement.

[2] *The Reuben H. Donnelley Corp.*, 95 F.T.C. 1, *rev'd sub nom. FTC v. Official Airline Guides, Inc.*, 630 F.2d 920 (2d Cir. 1980), *cert. denied*, 101 S. Ct. 1362 (1981)[450 U.S. 917 (1981)].

[3] 95 F.T.C. at 82.

[4] It is, of course, difficult to estimate aggregate excess prices paid by the disadvantaged dealers from the record. In 1977 GM paid approximately $98.8 million to dealers for crash parts under the wholesale compensation

(Continued)

function is subtracted, this premium, caused by the refusal of GM to deal directly, amounted to $36.9 million in 1977 alone. [3]

Moreover, this price differential is not the only advantage dealers have from GM's system. For every part GM sells to a dealer who in turn resells it at wholesale to an independent, GM pays the dealer 30% of the wholesale list price of the part under GM's wholesale compensation plan. While this system no doubt encourages dealers to resell parts—the reason it was urged by the Comission at its inception in 1968—it is also costly to GM. In addition, there is a not insignificant amount of "erroneous claims" and abuse accompanying the system, including claims for wholesale compensation by dealers who sell to *other GM dealers.* (IDF 111-112)

Against this competitive harm to independents and the losses to GM from the wholesale compensation plan, GM offers two justifications for its refusal to deal with independent body shops: 1) the system encourages new car sales by acting as an inducement to dealers to affiliate with GM initially and to sell additional new cars; and 2) opening up the distribution system to independents would be costly and entail some uncertainty. The majority specifically rejects the argument that incentives to dealers are significant to the degree necessary to constitute adequate justification for refusing to deal with independents. (Majority op. at 71–72) The majority, however, does accept the second argument as adequate justification.

We should be wary of justifying a monopolist's refusal to deal with a class of customers where competition is harmed substantially on the grounds that there are transaction costs in dealing with additional customers. A challenge to a monopolist's refusal to deal, by its nature, involves refusing to deal with a class of customers. Consequently, it will always be possible to posit that the transaction costs of dealing with additional customers justifies selective distribution. While it is certainly true that a more extensive distribution system is more expensive to manage, and should not be ignored in assessing net competitive effects, our focus must be on whether it outweighs *substantial* harm to competition.

The only record estimate of the extent of these added distribution costs was provided by Mr. Murphy, who estimated that it would cost $40 million to deal with 10,000 additional customers, or $4,000 per customer. (Tr. 10079) The majority concedes this estimate is "inflat-

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plan. (Tr. 16277–80) This amounts to 30% of the dealer price of qualified sales to wholesale customers. (IDF 73) Consequently, the aggregate dealer (or wholesaler list) price for parts sold to wholesale customers was approximately $327 million and the actual amount paid by these customers was about $235 million, assuming they received a 28% off list discount. (See majority op. at 49) Consequently, if the dealer price is reduced 17.7% from the independents, the total premium paid is about $41.6 million.

ed." (Majority op. at 74) Moreover, the testimony was given without explanation as to the components of the costs, nor without a clear explanation of whether the costs are one-time start up costs or recurring. Against this apparently [4]rather speculative estimate, which the majority concedes is inflated, the record showed excess prices of almost $37 million in 1977 on an *annual* basis.[5]

I cannot agree that GM has carried its burden in showing that the additional transaction costs of dealing with independent body shops outweighs the substantial harm to competition shown by complaint counsel. The record falls far short of proof adequate to justify a system which clearly raises prices to independents by millions of dollars and which, no doubt, drives up significantly the costs we all pay for dented fenders and crushed bumpers. For these reasons I dissent from the dismissal of the complaint.

CONCURRING STATEMENT OF COMMISSIONER CLANTON

I concur in the Commission's decision in this matter, but I have some observations about the rationale used to reach the legal standard in Part II.C. of the opinion. That standard, which is articulated on pp. 36 and 39, is identical to the approach adopted in our decision in *The Reuben H. Donnelley Corp.*, 95 F.T.C. 1, *rev'd sub nom. Federal Trade Commission v. Official Airline Guides, Inc.*, 630 F.2d 920 (2d Cir. 1980), *cert. denied*, 101 S.Ct. 1362 (1981)[450 U.S. 917 (1981)]. Nevertheless, while applying the substance of the *Donnelley* standard, the Commission's opinion in this case suggests that the precedent of *Donnelley* is unnecessary to the decision here since there is an adequate independent basis in prior case law for performing the same analysis and reaching the same result, *i.e., Associated Press v. United States*, 326 U.S. 1 (1945); *United States v. Terminal Railroad Assn.*, 224 U.S. 383 (1912); *Grand Caillou Packing Co.*, 65 F.T.C. 799, *aff'd sub nom. La Peyre v. Federal Trade Commission*, 366 F.2d 117 (5th Cir. 1966).

Presumably, the Commisssion's analysis is designed, at least in part, to avoid direct conflict with the Second Circuit's ruling in *Official Airline Guides*. I have two problems with that approach. In the first place, applying the *Donnelley* theory without calling it by that name is highly unlikely to change the outcome of judicial

[5] If independents were allowed to buy GM crash parts directly from GM, we would expect to see not only a reduction in prices charged by independents, due to lower costs, but an increase in volume done by them as people took advantage of lower prices, and a decrease in prices charged by the dealers as they responded to the competition. Consequently, the total spent by consumers could be reduced by more than the excess amount for crash parts paid by independents. We should keep in mind that GM's sale of crash parts is no small enterprise. Complaint counsel estimate that the dollar value of domestic shipments of these parts was about $549 million in 1977. (Majority op. at 6)

review in future cases. Certainly, such an approach will not succeed in the Second Circuit. Whether another court of appeals will agree with our *Donnelley* analysis is unknown,[1] but it is doubtful that the manner in which we characterize the rule will influence the end result. My second concern is that the analysis in this opinion seems to suggest a closer link between prior precedent and the Commission's present legal theory than we acknowledged in *Donnelley.* In *Donnelley,* the Commission recognized that the imposition of an obligation on lawful monopolists to deal fairly (or not arbitrarily) with firms seeking access to the monopolist's products or services fell outside the mainstream of monopolization law. Although in *Donnelley* the Commission felt that it was a "small step" from analogous case law to the standard enunciated [2]in that case, it was clear that the rule developed there did involve an extension of existing law, or at least the first clearly exclusive reliance on such an approach by either agency or court.[2] I agreed with that analysis and continue to do so. To the extent, however, that the Commission's opinion here suggests a different reading of the legal duty imposed upon non-colluding monopolists by the cases relied upon in *Donnelley,* I would disagree.

Final Order

This matter has been heard by the Commission upon the appeals of complaint counsel and respondent from the initial decision and upon briefs and oral argument in support of and in opposition to the appeals. For the reasons stated in the accompanying Opinion, the Commission has determined to sustain respondent's appeal. Complaint counsel's appeal is denied. Accordingly,

It is ordered, That the complaint is dismissed.

Chairman Miller did not participate.

Commissioner Pertschuk dissented.

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[1] It is possible that the Fifth Circuit Court of Appeals might reach a conclusion different from that of the Second Circuit. *See Fulton v. Hecht,* 580 F.2d 1243 (5th Cir. 1978); *La Peyre v. Federal Trade Commission,* 366 F.2d 117 (5th Cir. 1966).

[2] While language in *La Peyre* described a "duty of a lawful monopolist to conduct its business in such a way as to avoid inflicting competitive injury on a class of customers," 366 F.2d at 120, that dictum did not describe the issue squarely before the court and it was not necessary to its holding.

IN THE MATTER OF

GODFREY COMPANY

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket C-3066. Final Order, May 14, 1981—Modifying Order, June 28, 1982

This order reopens the proceeding and modifies the Commission's order issued on May 14, 1981 (97 F.T.C. 456), by modifying Paragraph I(G) of the order to relieve respondent from the obligation of divesting a specified retail grocery store.

ORDER MODIFYING CEASE AND DESIST ORDER ISSUED MAY 14, 1981

The Federal Trade Commission having considered respondent Godfrey Company's petition filed on March 12, 1982, to reopen this matter and to modify the consent order to cease and desist issued by the Commission on May 14, 1981, and having determined that reopening and modification of the order is warranted:

It is ordered, That this matter be, and it hereby is reopened and that Paragraph I(G) of the Commission's order be and it is hereby modified to read as follows:

(G) The "disposition stores" means the following Godfrey ("G") stores and Jewel ("J") stores:

1. G–427 (3045 S. 13th St., Milwaukee, WI.).
2. G–810 (3939 S. 76th St., Milwaukee, WI.).
3. J–1201 (1201 N. 35th St., Milwaukee, WI.).
4. J–729 (729 S. Layton Blvd., Milwaukee, WI.).
5. J–15182 (N81 W. 15182 Appleton Ave., Menomonee Falls, WI.).

IN THE MATTER OF

BROWARD COUNTY MEDICAL ASSOCIATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3091. Complaint, June 28, 1982—Decision, June 28, 1982

This consent order requires a Florida medical association to cease, among other things, inhibiting competition among health care providers by restricting its members from soliciting patients; advertising fees and services; and by declaring such activities unethical. The association is required to remove from its code of ethics, constitution and bylaws, any provision which is inconsistent with the prohibitions contained in the order; and publish revised versions of these documents. The order also requires that the association take no formal action against a party charged with violating an ethical standard without first providing that party with reasonable notice of the allegations and a hearing, as well as written findings and conclusions concerning the allegations. Further, for a period of ten years, the association is required to provide each new member with a copy of the order.

Appearances

For the Commission: *Steven T. Kessel* and *Laurel H. Brandt.*

For the respondent: *Pro se.*

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended (15 U.S.C. 41, *et seq.*), and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that the named respondent has violated the provisions of Section 5 of the Federal Trade Commission Act and that a proceeding by it in respect thereof would be in the public interest, hereby issues this Complaint, stating its charges as follows:

PARAGRAPH 1. Respondent Broward County Medical Association is a corporation formed pursuant to the laws of the State of Florida, with its mailing address at 2200 South Andrews Ave., Fort Lauderdale, Florida.

PAR. 2. Respondent is a professional association formed to reepresent the interests of physicians who practice in Broward County, Florida. Respondent has approximately 1500 members, constituting a substantial majority of physicians in Broward County.

PAR. 3. Respondent is a component society of the Florida Medical

Association, which is in turn a constituent society of the American Medical Association.

PAR. 4. Members of respondent are engaged in the business of providing medical health care services for a fee. Except to the extent that competition has been restrained as herein alleged, members of respondent have been and are now in competition among themselves and with other physicians.

PAR. 5. Respondent is organized for the purpose, among others, of guarding and fostering the interests of its members. Respondent engages in activities which further its members' pecuniary interests. By virture of its purposes and activities, respondent is a corporation within the meaning of Section 4 of the Federal Trade Commission Act, as amended. 15 U.S.C. 44.

PAR. 6. In the conduct of their business, members of respondent receive and treat patients from other states and counties, receive substantial sums of money from the federal government and from private insurers for rendering medical services, which money flows across state lines, and prescribe medicines which are shipped in interstate commerce. The acts or practices described below are in interstate commerce, or affect the interstate activities of respondent's members, third parties who pay for medical services, other third parties, and some patients of respondent's members, and are in or affect commerce within the meaning of Section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1).

PAR. 7. Respondent has acted as a combination of at least some of its members or has conspired with at least some of its members to foreclose, frustrate, and eliminate competition among medical doctors in Broward County, Florida by:

A. Prohibiting its members from truthfully advertising their services to the public, from distributing truthful information about their fees and services, and from otherwise soliciting patients' business; and

B. Coercing individual members into abandoning their efforts to truthfully advertise their services, to distribute truthful information about their fees and services, and to otherwise solicit patients' business.

PAR. 8. Respondent has engaged in various acts or practices in furtherance of this combination or conspiracy, including among other things:

A. Adopting and implementing written and unwritten codes of ethics that prohibit efforts by its members to truthfully advertise

their services in the Yellow Pages or in other media, or to otherwise distribute truthful information to the public about their fees and services. (See Exhibits A through C attached hereto). By virtue of such ethical restraints, members are prohibited from advertising, among other things: their fees; whether they accept Medicare assignment of benefits; whether they accept credit cards; their professional training and experience; their business hours and office locations; and their knowledge of languages other than English.

B. Publishing statements by some of its officials advising members that advertising is unethical and threatening disciplinary action and other sanctions against members who advertise. In particular, in 1981, respondent published and distributed statements by some of its officers advising its members that advertisement of their services in the Yellow Pages telephone directory was unethical, and that those members who violated respondent's written and unwritten proscriptions against advertising would be disciplined by respondent (See Exhibits B and C attached hereto);

C. Intimidating those members who seek to truthfully advertise their fees and services or to otherwise solicit patients' business by engaging in a concerted effort to obtain the names of those members and threatening to publish their names in respondent's membership magazine and subject them to the "ridicule of (their) peers" (See Exhibit C);

D. Sending letters to individual members who truthfully advertised their fees and services or who otherwise solicited patients' business that pressured those individual members to abandon such activities; and

E. Summoning individual members to meetings of respondent's Executive Committee and Board of Censors and threatening at those meetings to take disciplinary or other action to compel members to cease truthfully advertising their fees or services or otherwise soliciting patients' business.

PAR. 9. Through the combination or conspiracy and the acts or practices described above members of respondent have agreed not to, and do not, advertise their services or otherwise solicit patients' business, and certain individual members of respondent have been coerced into abandoning advertising their services or otherwise soliciting patients' business. Such advertising and solicitation enables physicians to compete on the basis of price, quality and convenience, and enables individual patients to choose among physicians on the basis of price, quality, or convenience. Consequently:

A. Competition among physicians for patients has been foreclosed, frustrated and eliminated; and

B. Consumers, including senior citizens among others, have been deprived of the benefits of competition among physicians. In particular, patients have been deprived of truthful information about physicians' fees and services, including, among other things: physicians' fees; whether physicians accept Medicare assignment of benefits; whether they accept credit cards; professional training or experience; their business hours and office locations; and their knowledge of languages other than English.

PAR. 10. The combination or conspiracy and the acts and practices described above constitute unfair methods of competition or unfair or deceptive acts or practices which violate Section 5 of the Federal Trade Commission Act. Such combination or conspiracy is continuing and will continue absent the entry against respondent of appropriate relief.

EXHIBIT A-1

DC003

Code of Ethics

EXHIBIT A-2

00003

CODE
PRINCIPLES OF MEDICAL ETHICS
BROWARD COUNTY MEDICAL ASSOCIATION

* * *

The Code is intended to establish certain general principles or rules of action and conduct for members of the Association. These principles are not rules to govern but are precepts to guide to correct conduct. "Custom is stronger than any law." —Ovid

* *

Chapter I

GENERAL PRINCIPLES

Section 1. CHARACTER OF THE PHYSICIAN. The prime object of the medical profession is to render service to humanity. Reward or financial gain is a subordinate consideration. Whoever chooses this profession assumes the obligation to conduct himself in accord with its ideals. A physician should be "an able and discreet man, learned in the art and science of healing." Milleniums ago Hippocrates summed up the character of a physician, "He should also be modest, sober, patient, prompt to do his whole duty without anxiety, piety without superstition, conducting himself with propriety in his profession and in all the actions of his life."

Section 2. THE PHYSICIAN'S RESPONSIBILITY. The profession of medicine having for its end the common good of mankind knows nothing of national enmities, of political strife, of sectarian or racial dissension.

Disease and pain, the sole conditions of its ministry, is disquieted by no misgivings concerning the justice and honesty of its client's cause but dispenses its peculiar benefits without stint or scruple to men of every country and party and rank and religion and to men of no religion at all.

Section 3. GROUPS AND CLINICS. The ethical principles actuating and governing a group or clinic are exactly the same as those applicable to the individual. As a group or clinic is composed of individual physicians, each of them, whether employer, employee or partner, is subject to the principles of ethics herein elaborated. The uniting into a business or professional organization does not relieve them, either individually or as a group, from the obligations they assume when entering the profession. A group of physicians in an association, corporation or otherwise organized together may not label their group or its place of practice as a 'clinic' or 'center' unless it consists of five or more physicians.

Section 4. ADVERTISING. Solicitation of patients directly or indirectly by a physician, by groups of physicians or by institutions or organizations is unethical. Among unethical practices are included the not always obvious devices of furnishing or inspiring newspaper or magazine comments concerning cases in which the physician or group or institution is concerned. All newspaper or magazine articles dealing in any way with medical subjects or the practice of medicine written by members of this association either alone or jointly with a newspaper or other reporter will be approved before publication by: (1) A majority of the members of this association practicing the branch of medicine involved; and also, (2) The Chairman of the Public Relations Committee of this association. The above in no way is to restrict the Chairman of the Public Relations Committee or the Broward County Health Department from

EXHIBIT A-3
00004

giving medical information of an emergency nature to the press. Self laudations defy the traditions and lower the moral standard of the medical profession. They are an infraction of good taste and are heartily disapproved.

The circulation of simple professional cards is limited to the giving of one card to a patient if requested. Distribution of cards to hotels, apartment houses, restaurants and the like is unethical. A modest simple announcement of the opening of a new office, change of address or association may be inserted in a newspaper not more than three times. The announcement should be limited to name, address, telephone number, office hours and specialty. Office signs should be limited in size to between two and one-half to three and one-half inch high letters and should be attached to the building or erected only a few feet from it. The use of large signs or neon or other lighted signs or the use of arrows or the distant placement of signs is not approved. Listing of a physician's name in a directory other than the telephone directory, professional directories, and non-commercial directories listing all doctors of medicine in the community without charge *is not approved*. The listing of a specialty for which the physician is not qualified as judged by the membership committee after review of his training and qualifications is fraudulent and unethical. Announcements or special notices may be sent through the mail in case of opening of a new office, removal or change of office, association or dis-association with other physicians, resumption of practice after a military or other leave of absence. These special notices may be mailed to physicians and former patients only. In all signs and directories, it is better not to use Doctor or Dr. The use of M.D. after your name is preferable.

Section 5. Educational Information. Not Advertising. Many people literate and well educated do not possess a special knowledge of medicine. Medical books and journals are not easily accessible or readily understandable. The Association considers it ethical for a physician to meet the request of the Associations' Public Relations Committee to write, act or speak for general readers or audiences. The physician should be guided by the decision of the Public Relations Committee in matters of this kind. The most worthy and effective advertisement possible for a physician is the establishment of a well merited reputation for professional ability and fidelity. This cannot be forced but must be the outcome of character and conduct.

Section 6. Patients, Commissions, Rebates, "Kick-Backs," and Secret Remedies. An ethical physician will not receive excessive remuneration from patients on the sale or rental of surgical instruments, appliances and medicines; nor any profit from a copyright on methods or procedures. The acceptance of "kick-backs," rebates on prescriptions or appliances or laboratory work or of commissions from attendants who aid in the care of patients is unethical. The physician should receive his remuneration for professional services rendered only in the amount of his fees specifically announced to his patient at the time the service is rendered or in the form of a subsequent statement and he should not accept additional compensation secretly or openly, directly or indirectly from any other source. It is considered unethical for any physician to charge excessive or exorbitant fees for his services. Furthermore, it shall be considered unethical for any physician to increase his fees by unnecessarily prolonging the care and treatment of any patient. The prescription dispensing or use by a physician of a secret medicine or other remedial agent of which he does not know the composition is unethical.

Section 7. Evasion of Legal Restrictions. An ethical physician will observe the laws regulating the practicing of medicine and will not assist others to evade such laws. He will observe those laws, not only in the letter but in the spirit of the law.

Chapter II

DUTIES OF PHYSICIANS TO THEIR PATIENTS

Section 1. Standards, Usefulness, Nonsectarianism. A sectarian or cultist as applied to medicine is one who alleges to follow or in his practice does follow a dogma,

00010 EXHIBIT A-4

TELEPHONE LISTINGS AND PAID NEWSPAPER ANNOUNCEMENTS

1. A physician may list his name, address, and telephone number in the *white pages* of any telephone directory published primarily for the municipality in which he maintains an office or a residence. He may list both residence and office. He must not permit any part of his listing to be printed in bold face type.

2. The physician's degree (M.D.) and the notation P.A. (if applicable) may appear after his given name, but no other designations, degrees are permissible; (exceptions, DMD or DDS, if earned dental degrees).

3. Residences need not be listed in the white pages.

4. A physician may not list in the white pages and professional information other than his office address and telephone number. However, he may list an alternate number in case of no answer.

5. A physician may list his name, address, and telephone number in the *yellow pages* of any telephone directory published primarily for the municipality in which he maintains an office or residence. He may list both residence and office.

6. Physicians names should be listed alphabetically under the heading, "Physicians and Surgeons, M.D." It is permissible in this general alphabetical listing to follow the physician's name with the simple statement, "Practice limited to ————."

7. In addition to the alphabetical listing, a physician may list himself under no more than two specialty or sub-specialty headings, provided he is Board Certified or Qualfied in, or limits his practice to, the primary specialty; and provided further that the specialty or sub-specialty is recognized by the American Medical Association and the Advisory Board for Medical Specialties, and that examination for certification is being conducted.

8. Each physician who uses multiple listings must be prepared to justify these listings if called upon to do so. The BCMA office keeps a current listing of recognized specialties, and may be consulted at any time.

9. A statement that the physicians practice is limited may appear under the general listing only. A brief statement of office hours or a note that patients are seen by appointment only is acceptable. Alternate phone or answering service number may be listed.

10. *NOT ACCEPTABLE:*

    Bold Face Type.

    Listings boxed by lines or rules.

    Any statement such as "Diplomate of the American Board of ————." or "Fellow of the American College of ————."

    Any language, symbol or device that tends to direct attention to one particular listing or that could be construed as advertising. i.e., Techniques, Procedures, or Specific Disease entities.

11. Newspaper Announcements:

    A member may purchase newspaper space for the following:

    A. To announce the opening of an office of a physician new in the community.

    B. To announce the relocation of a professional office to a new address or the establishment of a second office.

    C. To announce the association of a new physician with an established professional office.

EXHIBIT A-5 CC011

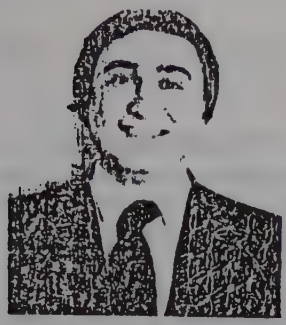
D. To announce that an office will be closed for an extended period (30 days or more) for reason of illness, vacation or other cause, and to announce the reopening of the office. However, if the office telephone is to be answered by office or answering service, announcements will not be permitted.

12. The number of insertions should not exceed four within a 30 day period. Insertions limited to two column width (5 inches) and three inches in depth. Type size not to exceed 18 point. Black ink, and not surrounded by excessive white space.

13. Use of pictures, drawings, logotypes expressly forbidden.

The Association will take disciplinary action as may be indicated against violators; except that the Judicial Council of the Florida Medical Association may intervene if the Association fails to take adequate and proper action.

EXHIBIT B



I was encouraged by the recent publication of the telephone book yellow page directory. In spite of a dishonest campaign by certain employees of Southern Bell Telephone Company to induce physicians to alter their yellow page listings, a relatively small number of BCMA members responded contrary to our association's Code of Ethics. Those physicians who took advantage of the opportunity to alter their listing and/or subscribe to a small ad in the yellow pages will be summarily called before the Executive Committee of the BCMA to explain their actions.

Let there be no doubt that in spite of the Federal Trade Commission's contention that restriction of advertising is tantamount to restraint of trade, the "principles" of medical ethics in Broward County remain unchanged. Exceptions to the standard yellow page listing, including bold face type, will continue to represent conduct unbecoming to a professional.

It is my hope that tradition will prevail over law.

Phillip A. Caruso, M.D.
President

EXHIBIT C

FROM THE PRESIDENT'S DESK

BCMA NEWS LETTER

Dear Colleague: June, 1981

YELLOW PAGE ADVERTISING

Your Executive Committee for years has been waging a campaign against unwarranted listings in the Yellow Pages. The primary reason is that we do not believe such flagrant listings are ethical, for ours is a profession in which dignity is and should be one of our foremost tenets.

The BCMA, as a guardian of the highest principles in medicine, has asked those who broke our unwritten code to swear and offer explantation. Names henceforth will be published in THE RECORD.

The most frequent excuse is a plea of ignorance; that an office girl was responsible.

Come September you will be called again by those who market space in the Yellow Pages. It would behoove you to advise your staff that you alone are responsible for what appears in those listings, and that they must be cleared by your personally. Better that them to suffer the ridicule of your peers!

ON PROFESSIONAL LIABILITY

All insurance codes, including professional liability, is due for review in 1982 by the Florida Legislature.

We have scheduled a special September session on the subject of risk management with PIMCO and you will be kept advised as plans are formulated.

IMPAIRED PHYSICIANS PROGRAM

Member volunteers are being sought for a BCMA committee to work with the Florida Medical Foundation-Florida Medical Association Impaired Physicians Program. Such volunteers will serve primary physicians in their area to monitor physicians who have completed treatment and are returning to their local county.

If you are interested in serving, please contact Bill Stafford at the BCMA offices, (525-2142).

IRISH TRIP CANCELLED

The proposed golf-sightseeing trip to Ireland in August has been cancelled because of lack of participation. Time obviously was too short. We will start at year's end to line up a trip for next July, hoping that this will give more members an opportunity to plan ahead and thus be able to participate.

BCMA TELEVISION SHOW

We have ceased taping our half hour medical show on HBO Channel 25 for the summer but will resume in September. Plans are in process to televise these shows in the Plantation and Hollywood areas futurely. Members interested in appearing on the program when taping is resumed are urged to contact Public Information Director Oscar Fraley (527-0778) for a list of shows we already have done so that you may come up with a new approach.

This is my opening news letter as your new president and I will strive to keep you fully informed of everything we are doing in your interests at the BCMA

Sincerely,

Decision and Order

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent and counsel for the Commission having thereafter excuted an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comment filed thereafter by an interested person pursuant to Section 2.34 of its Rules, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Broward County Medical Association is a corporation organized, existing and doing business under and by virtue of the laws of the State of Florida, with its office and principal place of business located at 2200 South Andrews Ave., in the City of Fort Lauderdale, State of Florida.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

Order

I.

For purposes of this order, the following definition shall apply:

A. *BCMA* means respondent Broward County Medical Associa-

tion, its delegates, trustees, councils, committees, Board of Censors, officers, representatives, agents, employees, successors and assigns.

II.

It is ordered, That BCMA shall cease and desist from, directly or indirectly, or through any corporate or other device:

A. Restricting, regulating, impeding, declaring unethical, interfering with, or advising against the advertising or publishing by any person of the prices, terms or conditions of sale of physicians' services, or of information about physicians' services, facilities or equipment which are offered for sale or made available by physicians or by any organization with which physicians are affiliated;

B. Restricting, regulating, impeding, declaring unethical, interfering with, or advising against the solicitation, through advertising or by any other means, including but not limited to bidding practices, of patients, patronage, or contracts to supply physicians' services, by any physician or by any organization with which physicians are affiliated; and

C. Inducing, urging, encouraging, or assisting any physician, or any medical association, group of physicians, hospital, insurance carrier, telephone company or any other non-governmental organization to take any of the actions prohibited by this part.

Nothing contained in this part shall prohibit respondent from formulating, adopting, disseminating to its members, and enforcing reasonable ethical guidelines governing the conduct of its members with respect to representations, including unsubstantiated representations, that would be false or deceptive within the meaning of Section 5 of the Federal Trade Commission Act, or with respect to uninvited, in-person solicitation of actual or potential patients, who, because of their particular circumstances, are vulnerable to undue influence.

III.

It is further ordered, That BCMA shall cease and desist from taking any formal action against a person alleged to have violated any ethical standard promulgated in conformity with this Order without first providing such person with:

A. Reasonable written notice of the allegations against him or her;

B. A hearing wherein such person or a person retained by him or her may seek to rebut such allegations; and

C. The written findings or conclusions of respondent with respect to such allegations.

IV.

It is further ordered, That BCMA shall:

A. For a period of ten years, provide each new member of BCMA with a copy of the complaint and this Order at the time the member is accepted into membership;

B. Within sixty (60) days after this Order becomes final, publish a copy of the complaint and this Order with such prominence as feature articles are regularly published in the BCMA *Record* or in any successor publications;

C. Within ninety (90) days after this Order becomes final, remove from its *Code of Ethics,* its constitution and bylaws, and any other existing policy statements or guidelines of respondent, any provision, interpretation or policy statement which is inconsistent with Part II of this Order, and within one hundred and twenty (120) days after this Order becomes final, publish in the BCMA *Record* or in any successor publications the revised versions of such documents, statements, or guidelines;

D. Within one hundred and twenty (120) days after this Order becomes final, file a written report with the Federal Trade Commission setting forth in detail the manner and form in which it has complied with this Order;

E. For a period of five (5) years after this Order becomes final, maintain and make available to the Commission staff for inspection and copying upon reasonable notice, records adequate to describe in detail any action taken in connection with the activities covered by Part II of this Order, including but not limited to any advice or interpretations rendered with respect to advertising or solicitation involving any of its members; and

F. Within one year after this Order becomes final, and annually thereafter for a period of five (5) years, file a written report with the Federal Trade Commission setting forth in detail any action taken in connection with the activities covered by Part II of this Order, including but not limited to any advice or interpretations rendered with respect to advertising, or solicitation involving any of its members.

V.

It is further ordered, That BCMA shall notify the Commission at least thirty (30) days prior to any proposed change in the respondent, such as dissolution, assignment, or sale resulting in the emergence of a successor corporation or association, or any other change in the corporation or association which may affect compliance obligations arising out of this Order.

Minor deviations from previously issued Consent Order's model year designation guidelines would be permissible for trucks manufactured to fill fleet order specifications in situations where manufacture of the fleet of vehicles overlap model year changeover date. [*Paccar, Inc., C-2981*]

January 11, 1982

Gentlemen:

This responds to your request, by letter of May 27, 1981, for advice as to whether the Commission would seek to enforce the above referenced order against Paccar in cases where it uniformly assigns succeeding model year designations to fleet order vehicles (10 or more) manufactured during production runs which overlap the model year changeover date.

The order is designed to protect original and secondary retail purchasers of heavy duty trucks from model year misrepresentations made orally and on certificates of origin, and on any other documents identifying such vehicles. In pertinent part, the order provides:

It is further ordered, That respondent shall not represent orally or in any document identifying any vehicle, or in any advertisement or promotional material, or in any number or code incorporated into a vehicle identification number, that any vehicle is of a particular model year, or designate or cause to be designated any vehicle as being of a particular model year, unless for each such vehicle:

1. Such designation or representation is made in accordance with written designation standards which clearly identify the vehicles to which they apply and the starting dates when such standards take effect; and
2. The aforementioned designation standards are uniformly applied throughout a model year to all vehicles of the same model assigned a model year designation, whether such vehicles are distributed for sale to the first retail purchaser through factory-owned branches or through dealers; and
3. The aforementioned designation standards are such that the model year asigned particular vehicles is determined by:

a. The characteristics of the vehicles designated, or
b. The date of manufacture (regardless of the extent, if any, of changes in physical characteristics from vehicles of a preceding model year); *provided, however,* that;

(1) Vehicles whose assembly began before the model year changeover date but were completed after such date, may be designated as being of the earlier model year, and
(2) Where a particular model is manufactured in two or more plants, all vehicles of that model manufactured after a particular date in one plant and after a later date (or dates) in another plant (or plants) may be designated as being of the same model year provided that the date of manufacture of the last vehicle designated as of a particular model year in any plant, occur no later than thirty (30) days after the date of manufacture of the first vehicles designated as of the succeeding model year in any other plant;

4. All vehicles designated as being of a particular model year shall be so designated on or before the date of manufacture; and

5. All vehicles once designated as being of a particular model year shall remain so designated except that the model year designation may be corrected when a vehicle at the time of manufacture is assigned an incorrect designation which is inconsistent with the previously established standards;

provided, however, that nothing in this order shall require that the first and last days of a model year coincide with the first and last days of the corresponding calendar year.

For purposes of this order, the date of manufacture shall be the date upon which the last act of manufacturing or assemblage to be performed by respondent is completed by respondent. Further steps of manufacture by a later state manufacturer (for example, the installation of a truck body) however initiated or contracted shall not affect the date of manufacture of vehicles manufactured by respondent, for the purposes of this order.

In your letter of May 27, you state that design changes to the trucks manufactured by Paccar's Kenworth and Peterbilt divisions are made on an irregular basis, so that a difference in model year between two trucks of the same type does not normally mean that the trucks are physically different. Your letter indicates that model year designations are significant in other respects, however. Price increases are usually timed to occur with model year changes. Furthermore, fleet orders handled by Kenworth and Peterbilt typically specify that fleet vehicles be identical in price and other characteristics.

We understand that under Subpart 3(b) of the order quoted above, Paccar has elected to use the date of manufacture as the standard for model year designations. The company states that in those instances where fleet production straddles the standard model year changeover date, a conflict develops between the customer's requirement that all trucks in the fleet have identical model years (and prices) and the order's apparent requirement that trucks produced before the changeover date have an earlier model year designation than those produced afterward. Your letter advises that to avoid this conflict, Paccar presently delays the completion of fleet vehicles until after the changeover date. This solution disrupts the manufacturing process, however, and it imposes artificial costs on fleet production during the model changeover period.

Your letter states that "[t]o allow the divisions to complete the manufacture of some of the vehicles which are part of a fleet order prior to the 'model year' changeover date but deliver them after that date and designate them at the later model year does not violate the intent of the order." We understand that Paccar has offered to notify the Commission each time this approach is taken.

The Commission believes that no harm to competitors or purchasers would result if fleet vehicles manufactured by Kenworth and Peterbilt shortly before the standard model year changeover date are designated with the succeeding model year. The Commission will take no enforcement action with respect to such designations if the following conditions are fulfilled:

(1) Paccar must notify the Commission of each fleet order so affected, and for each provide:

(a) the name and address of the fleet customer(s);
(b) the number of vehicles comprising the fleet, and their make and model;
(c) the vehicle identification number (VIN) for each fleet vehicle;
(d) the model year changeover date(s);
(e) the date of delivery for the fleet; and
(f) the model year designation assigned to the fleet;

(2) The foregoing information should be submitted to the Commission as a supplemental compliance report no later than thirty (30), days after the fleet is delivered; and
(3) Only vehicles whose last act of manufacturing occurred within the period thirty (30) days before or thirty (30) days after the model year changeover date are included under this exception.

The foregoing statement of enforcement intention is binding upon the Commission with respect to Paccar, Inc., and with regard to the acts, practices, and conduct described in the request, so long as all relevant facts were fully, completely and accurately presented to the Commission, until such time as the statement has been rescinded or revoked and notice thereof has been given to the requester. No enforcement actions will be initiated by the Commission concerning any conduct undertaken by the requester in good faith reliance upon the foregoing statement where such conduct is discontinued promptly upon notification of rescission or revocation of the Commission's statement.

Notwithstanding its present determination, the Commission will not be precluded from later taking appropriate action if it subsequently learns that violations concerning other aspects of the order have occurred or that the information submitted in the abovementioned request was inaccurate or incomplete, or if it determines that such further action would serve the public interest.

Finally, the Commission notes that it has issued orders, similar to Paccar's, against other truck manufacturers. These manufacturers may also have encountered compliance problems concerning the assignment of model years to fleet vehicles produced during a model

year change. Accordingly, they may wish to seek the Commission's advice on acceptable means of making model year designations in such circumstances. To assist them in submitting such requests, the Commission has determined that a copy of this letter should be placed on the public record along with Paccar's letter dated May 27, 1981.

By direction of the Commission.

Letter of Request

May 27, 1981

Gentlemen:

As we have discussed on several occasions, the present form of the referenced Consent Order presents a potential problem for our Kenworth and Peterbilt truck divisions with regard to the scheduling of customer fleet orders during the time of our "model year" changeover date.

As you are aware, Kenworth and Peterbilt build Custom trucks. Neither division makes physical changes to its vehicles to correspond to a model year. Product improvement and style changes are normally evolutionary and introduced when completed. Therefore, there is normally no physical difference in the vehicle between any consecutive model years. The divisions usually do coordinate a price increase, if one is necessary, with the "model year" change.

When a customer orders a fleet of vehicles, it normally "specs" all the vehicles identically and a uniform price is established for all the vehicles. If manufacture of a fleet is in progress on a model changeover date, some vehicles will bear the present model year designation and some will bear the next year's model designation with corresponding differences in price. Since all the vehicles are mechanically the same, this situation is unacceptable to the fleet customer. It is, likewise, unacceptable to disrupt the manufacturing process so that all the fleet vehicles will bear the same model year designation.

Both divisions attempt, to the extent practical, to schedule fleet vehicles so that their production is not interrupted by the "model year" changeover date. But, on occasion, because of production factors and other promised delivery dates, it cannot be avoided.

Under the present terms of the Consent Decree, the divisions have only one alternative in order to provide the fleet customer with what he ordered and still maintain its production schedule and delivery deadlines; to not complete the manufacturing process on any of the

trucks, regardless of when they began down the production line, until after the "model year" changeover date. Although this would allow all of them to be designated as the later model year, this solution is both costly and disruptive.

To allow the divisions to complete the manufacture of some of the vehicles which are part of a fleet order prior to the "model year" changeover date but deliver them after that date and designate them as the later model year does not violate the intent of the order.

Paccar does not believe that either party to the Consent Order contemplated this problem or the unsatisfactory and limited solution. Paccar, therefore, requests that the FTC provide relief from this situation. The wording of the Consent Order does not lend itself to an interpretive letter as a method of relief. Paccar suggests resolving the matter by the FTC providing Paccar an official letter stating that as long as Paccar notifies the FTC of any situation where the production of vehicles for a fleet overlaps the "model year" changeover date, the FTC will not consider it a material violation of the order and will not initiate any action, enforcement or otherwise, under the Consent Order against Paccar because of such a situation.

Your consideration in this matter is appreciated.

Very truly yours,

/s/ Kenneth R. Brownstein

Counsel

Code of ethics, proposed by stevedoring and marine terminal industry trade association, that requires expulsion from the association for conviction or guilty plea to unlawful acts warrants no enforcement action by FTC. [*P82-3803, National Association of Stevedores*]

March 9, 1982

Dear Mr. Wilcox:

The Federal Trade Commission has considered your request for an advisory opinion dated September 9, 1981.

The Commission understands that the National Association of Stevedores (NAS) is a trade association of domestic stevedores and marine terminal operators. Stevedores provide port services, contracting with the owner or operator of a vessel to load and unload the vessel at a marine terminal. The Association was founded in 1933 and has 66 full and 2 associate member companies.[1] These member companies represent approximately 75 percent of the total workhours performed by stevedores other than at inland river terminals. Members operate in all the major coastal areas: Great Lakes, North Atlantic, South Atlantic, Gulf Coast, West Coast, Hawaii and Puerto Rico.

The Association primarily monitors federal and state legislation and regulation which may affect the stevedore industry. In addition, the Association performs lobbying services, provides its members access to Congress, analyzes relevant court decisions, and, on occasion, files *amicus* briefs.

In response to legislative hearings by the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate and to recommendations made to NAS by the Subcommittee Chairman and ranking minority member, NAS proposes to make effective a "Code of Business Ethics of the National Association of Stevedores." This ethical code was approved by the NAS Board of Directors on June 16, 1981, and will become effective upon approval by the Federal Trade Commission.

The proposed code declares the policy of NAS member companies with regard to lawful competitive and business practices. The first six sections express the general policies of the Association but provide no sanctions. Section 7 establishes a special rule for automatic termination of membership when any member company pleads guilty

[1] Associate members pay 75% of full membership dues, but are not entitled to vote or hold office. The two current associate members include a Hawaiian stevedore who is too far away to attend NAS functions and a New England stevedore who performs only approximately 10,000 workhours a year. Membership dues are currently a basic fee of $1500 plus an assessment based on workhours performed.

to or is convicted of making illegal payments or other illegal acts. This rule includes explusion of the member company when any officer pleads guilty to or is convicted of such acts committed with the knowledge of the president and/or board of directors. Section 8 of the proposed code provides a procedure whereby a member terminated pursuant to Section 7 can seek reinstatement.[2]

These two last provisions raise a possible antitrust issue if restrictions on membership result in competitive harm and such restrictions are imposed without adequate procedural safeguards.

The Commission issues the following advice pursuant to Rule 1.1 of its Organization, Procedures and Rules of Practice, 16 CFR 1.1, because it believes that the publication of such advice is of significant public interest.

Based upon the information furnished to the Federal Trade Commission by NAS and the Commission's understanding of the nature and scope of the Association's activities, the Commission does not presently intend to commence enforcement proceedings against NAS or its member companies if they make effective the "Code of Business Ethics of the National Association of Stevedores."

The Commission's present enforcement intentions are based primarily on its view that denial of membership in NAS would not presently have substantial competitive effects. NAS represents that membership in the Association does not confer any particular competitive advantages. Activities of the Association appear to benefit nonmembers as well as members. It thus appears that, at this time, exclusion from NAS would not competitively disadvantage a member company and would not constitute an unlawful restraint of trade. Consequently, the Commission has concluded that no enforcement action based on the proposed code is warranted.

Circumstances may change, however, and loss of NAS membership and resulting benefits may come to represent a significant competitive disadvantage. The Association should be aware that in those circumstances any membership restriction such as exclusion, suspension, or termination that is unreasonable or made without adequate procedural safeguards could result in an antitrust violation.[3]

If membership in the Association were to become a valuable property right and competitive factor, certain actions performed by the Association pursuant to the proposed ethical code would be likely to raise enforcement concern. They include (1) arbitrary application of the provision permitting termination of a member company for

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[2] Article III, Section 6 of the Association By-Laws currently provides that NAS may suspend or expel any member company, after notice and an opportunity for hearing, for any of a number of violations including violation of any rule or practice of the Association. The activities covered by Section 7 of the proposed code are the only activities for which a member company will be automatically expelled from the Association without a prior hearing.

[3] *See, e.g., Silver v. New York Stock Exchange,* 373 U.S. 341 (1963).

"other unlawful acts" which are not corrupt practices declared illegal by the Taft-Hartley Act, 29 U.S.C. 186; (2) automatic termination of a member company without a proper determination that a person who pleaded guilty to or was convicted of unlawful payments was in fact an officer for whose conduct the company properly may be held responsible and that the president and/or board of directors had sufficient knowledge of the acts committed; or (3) refusal to grant an application for reinstatement by a member company without applying fair and objective standards or criteria. Use of procedures such as those provided in Article III, Section 6, of the Association By-Laws, in certain circumstances could provide appropriate procedural safeguards.

This opinion is being rendered solely upon the issue of membership termination pursuant to your proposed "Code of Business Ethics." It does not cover any other course of action by NAS or its member companies, such as concerted refusals to deal, that might constitute a commercial boycott or other collusive behavior in restraint of trade. The Commission reserves the right to commence enforcement proceedings against any conduct that was not disclosed in the request and to rescind the advice in accordance with Rule 1.3 of its Rules of Practice, 16 CFR 1.3, if warranted.

By direction of the Commission.

Letter of Request

September 9, 1981

Dear Secretary:

Pursuant to Rules 1.1-1.4 (16 CFR 1.1-1.4) of the Commission's Rules and Regulations, the National Association of Stevedores (NAS) hereby requests the Federal Trade Commission for an advisory opinion concerning the implementation by the NAS of the enclosed proposed NAS Code of Business Ethics, and in particular whether the implementation of the proposed Code would be in violation of Section 5 of the Federal Trade Commission Act (15 U.S.C. 45); Section 1 and 2 of the Sherman Act (15 U.S.C. 1 and 2) and/or any existing rule or regulation promulgated by the Commission.

The Association

The NAS is a trade association incorporated under the laws of the District of Columbia and has obtained Section 501(c)(6) non-profit tax exemption from the Internal Revenue Service. Article II of the Bylaws of the NAS states that "The object and purpose of the Association is to promote, further, and support the stevedoring and

marine terminal industry in the United States and its territories and possessions". At present the NAS has 66 member companies which operate at all major ports on the four seacoasts of the United States, the states of Alaska and Hawaii and the commonwealth of Puerto Rico. Although the member companies of the NAS account for some 75 percent of all industry manhours (excluding inland river operations) there are many stevedore/marine terminal operators who are not members of the NAS.

A stevedore is either a person or company who contracts with the owners or operators of a vessel for the loading and unloading of the vessel when in port. A marine terminal operator is the owner/operator of the facility at which water-borne cargo is loaded or unloaded. In some instances the marine terminal operator and the stevedore contrator may be the same, or corporately related, entity. In many instances the stevedore and the marine terminal are unrelated entities, and the latter often is a public instrumentality, either state or local. The stevedore/marine terminal operator hires longshoremen to perform its contractual duties with ship owners pursuant to collective bargaining agreements with two major longshore unions—the International Longshoremen's Association (ILA) on the East and Gulf Coast, the Great Lakes, and Puerto Rico, and the International Longshoremen's and Warehousemen's Union (ILWU) on the Pacific Coast, Alaska and Hawaii.

The activities of a stevedore contractor are not subject to economic regulation by any federal agency. Some activities of a marine terminal operator are subject to regulation by the Federal Maritime Commission and the Shipping Act, 1916 (46 U.S.C. 801, *et seq.*). However, the regulatory scope of the Shipping Act does include matters such as the proposed Code.

The stevedoring/marine terminal industry is highly competitive. There is competition between companies in each port in which more than one is in business, and there is competition between ports. To date there is no evidence that membership in the NAS has any significant effect on competition.

The Reasons For the Code

One of the purposes and major goals of the NAS is to improve the public's and government's images of the industry. The industry is little understood and over the years has suffered from adverse publicity. The NAS was attempting to correct that situation when in 1977 the Department of Justice revealed the largest labor racketeering investigation and strike force in its history—Operation UNIRAC. Operation UNIRAC resulted in numerous convictions of both waterfront management and labor and culminated in hearings in February,

1981, before the Senate Permanent Subcommittee on Investigations. A detailed account of those hearings is enclosed* (*American Shipper*, April, 1981, pgs. 4-14) and the printed record of the hearings is available should the Commission require.

At the conclusion of those hearings Senators Nunn and Rudman issued a joint statement, a copy of which was sent to the NAS (letter dated March 12, 1981, enclosed*). Item 7 of those joint recommendations stated that industry trade associations should establish strict ethical standards of conduct for their members. Upon receipt of the recommendations the NAS contacted Senator Nunn, the Department of Justice, and the Federal Trade Commission. On March 26 Senator Nunn addressed the Annual Meeting of the NAS (speech enclosed*) and presented some specific recommendations for an industry code of ethics (pages 7-11 of enclosed* speech). The NAS immediately undertook the establishment of an effective code of business ethics and so advised Senator Nunn.

The proposed Code of Business Ethics was formally adopted by the NAS Board of Directors on June 16, 1981, and a copy was sent to Senator Nunn and Commission staff for comments. Senator Nunn's letter of July 28, 1981 is enclosed.* On August 25 the NAS membership was informed of the Board's actions and was sent a copy of the proposed Code of Business Ethics and memorandum of explanation (copy enclosed*).

The proposed Code is not now in effect and will not be implemented until receipt of an advisory opinion from the Commission. Should the Commission recommend changes to the proposed Code, the Code will not be implemented until those recommendations are adopted. In that regard, the NAS has its semiannual meeting on September 23-25, 1981, and we respectfully request a response from the Commission prior to that meeting so that prompt action may be taken to establish and implement an effective and lawful Code of Business Ethics.

We have carefully reviewed the applicable law and Commission rules and published Administrative Opinions and Rulings (16 CFR 15.1-15.491) and believe that the proposed Code does not violate any of them. In all cases, save one, a member company may be disciplined only after notice and hearing by the NAS Board of Directors. We believe that automatic termination of membership upon conviction of a crime is not discriminatory or arbitrary, and that the conviction of

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*Not reproduced herein. Copies of all Attachments are available for inspection in Room 130, Public Reference Branch, Federal Trade Commission, 6th St. and Pa. Ave., N.W., Washington, D.C. 20580.

a crime, or a plea of guilty, is just as damaging to one's reputation or ability to compete as explusion from the NAS.

We look forward to early advise by the Commission.

Sincerely yours,

/s/ Thomas D. Wilcox

Executive Director and General Counsel

Peer review plan for resolving fee-related disputes. [*823 0001, Iowa Dental Association*]

April 3, 1982

Dear Mr. Sfikas:

This is in response to your request for an advisory opinion concerning a proposed program for peer review of dental fees by the Iowa Dental Association ("IDA" or "Association") and its component district dental societies.

It is the Commission's understanding that IDA wishes to institute a peer review program to aid the cost containment efforts of third-party payors[1] and assist patients in the resolution of fee-related disputes with dentists. Under the proposed IDA peer review program, a patient, a third-party payor or a dentist involved in a particular fee dispute may request a determination by a peer review panel of an IDA component district dental society as to the appropriateness of the fee charged in that particular case. Participation in the program will be purely voluntary (with no proceeding held unless each of the disputants agrees to participate)[2] and all determinations will be purely advisory in nature. Furthermore, the decision of each peer review panel will be based solely on the facts and circumstances of the particular case and will not be disseminated beyond the patient, third-party payor, and dentist involved in the case. Similarly, distribution of decisions internally will be limited to the dissemination required to perform appellate and administrative functions, and the Association will neither collect information on dental fees nor conduct surveys relating to such fees.

Based on its understanding of the fee peer review program as it is outlined above and further detailed in your submissions, it is the Commission's opinion that operation of the program would not, in and of itself, be violative of Section 5 of the Federal Trade Commission Act.

The Commission is of the view, however, that great care must continually be taken in carrying out the program to assure that its purpose remains legitimate and that it does not produce significant an-

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[1] Third-party payors (also called "third-party providers" in IDA's submissions) are entities — such as insurance companies, service companies, or employers — who reimburse patients for all or part of the cost of dental care, or make direct payments to dentists on behalf of patients for such services.

[2] Thus, when a dispute is between a third-party payor and a dentist, both the third-party payor and the dentist must agree to participate in the particular proceeding. Likewise, when the dispute is between a patient and his or her dentist, both the patient and dentist must agree to participate for the peer review process to be utilized.

ticompetitive effects and thereby run afoul of the antitrust laws.[3] Proffered guidance given under the auspices of a major professional society can readily become coercive if the voluntary and advisory nature of the program is not perceived and sustained by all participants. Likewise, joint action relating to fees can readily threaten independent pricing, if determinations about particular past prices become generalized in future fee or reimbursement decisions. IDA should avoid antitrust risk, therefore, by vigilantly safeguarding the voluntary and advisory nature of the fee peer review process, and the limited scope of each proceeding, to prevent a lessening of price competition or innovation and to avoid unlawful coercion.

Competition will be best protected if all concerned parties view fee peer review as a means of mediating specific fee disputes, rather than a process for the collective sanctioning of fee levels or particular practices. The Commission believes that limited dissemination of fee decisions by the peer review panels is crucial if the program is to serve as a mediation service, rather than a means to faciliate price fixing or coercion. Serious antitrust concerns would therefore arise if IDA, district societies, Association members, or the disputants involved in particular peer review proceedings allowed panel decisions to become widely known.

Of equal importance, the difficulty and complexity of a procedure should be evaluated based on the individual expertise and judgment of the panel members. To the extent that any reference is made to external factors or benchmarks, such as relative value scales, consideration should be limited to fee information not sponsored or sanctioned by the Association or a component dental society. Likewise, peer review of fees would be subject to antitrust challenge if it were used either to discipline dentists who engage in advertising or other forms of competition or to discourage innovative practices not officially approved or widely used within the professional community. The Association should take no steps to discipline either panelists who do not follow IDA's policies or member dentists who decline to utilize the peer review process or accept its guidance.

To prevent unlawful coercion of third-party payors, IDA should make it clear that the Association is neither conferring preferred status on insurers and other companies that participate in the program and accept panel recommendations, nor urging members den-

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[3] The Supreme Court will clarify in a pending case the extent to which peer review is within the antitrust exemption for the "business of insurance" under the McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq. Pireno v. New York State Chiropractic Association*, 650 F.2d 387 (2d Cir. 1981), *cert. granted*, _____ U.S. _____ (Sup. Ct. Nos. 81-389, 81-390 Nov. 16, 1981). It therefore does not seem warranted for the Commission to offer its own advice to IDA on this issue at this time.

tists to avoid or pressure companies that fail to participate in the program and acquiesce in panel recommendations. Furthermore, antitrust concern would be triggered if the program were used to determine whether a third-party payor's fee schedule or reimbursement program is sufficient or reasonable — the likelihood that the program would have anticompetitive effects would be minimized if it only determines the appropriateness of a particular dental fee charged in a particular case. Likewise, the fee review program may not be used to pressure third-party payors into accepting or standardizing particular definitions of what is a "usual" or "customary" fee. When a dispute involves one of those terms, antitrust risk would be reduced if the panel takes the third-party payor's definition as given.

Furthermore, dentist-patent disputes need to be handled with special care when no third-party payor is involved. A third-party payor independently establishes its own general contractual criteria and standards for reimbursement and is often able to make an independent appraisal of the overall fairness of the fee peer review process and of individual peer review decisions. A patient bringing a claim to the program will have no previously established criteria or payment formula and will usually be unable to make such appraisals. And, unlike the third-party payors, the patient may not have the financial ability or incentive to defend his or her position in court if dissatisfied with the peer review determination. Where no insurance contract or prior fee agreement between dentist and patient exists, IDA should be particularly careful not to let the peer review process be used to set or sanction particular "reasonable" or "customary" fee levels for general use by members. Also, it is most important that the patient be made aware of the voluntary and advisory nature of the process and, if he or she chooses to participate, be given a fair hearing. IDA might specifically advise patients that peer review determinations are based on the experience and judgment of the individudal panel members and do not represent formal adjudications, based on a formula, that the patient is bound to accept. IDA might also consider adding safeguards that will help assure that dentist-patient disputes are resolved in an even-handed manner. Though not required, having local consumer organizations help select "consumer representatives" to be added to panels hearing such disputes might be one such safeguard. Alternatively, local government representatives or consumer organizations might supply IDA or their district dental society with a list of knowledgeable "consumer advisors" to assist a patient who chooses to participate in fee peer review.

Lastly, the Commission maintains the right to reconsider the questions involved or to rescind or revoke its opinion in accordance with Section 1.3(b) of the Rules of Practice in the event that implementation of the peer review program results in anticompetitive effects,

should the purposes of the program no longer remain legitimate, or should the public interest otherwise so require.[4]

By direction of the Commission.

Letter of Request

March 17, 1981

Dear Secretary Thomas:

I represent the Iowa Dental Association (IDA) and on their behalf we hereby request an Advisory Opinion, pursuant to 16 C.F.R. 1.1, permitting IDA to engage in peer review of fees of Iowa dentists.

Frequently, consumers, and in most instances, third-party providers, request IDA's guidance in determining whether fees charged by particular dentists are "excessive" or "unreasonable." IDA should be permitted to aid in this cost containment effort by providing its judgment, when requested, about the reasonableness of specific fees in light of the facts and circumstances of a particular case.

As you are aware, there is ample case support for the proposition that peer review of professional fees is lawful. In *Bartholomew v. Virginia Chiropractors Association,* 612 F.2d 812 (4th Cir. 1980), *cert. denied* 100 S.Ct. 158 (1980), the Court of Appeals upheld a system whereby the Virginia Chiropractors Association, through peer review, advised insurance companies whether questioned fees from chiropractors exceeded usual, customary and reasonable levels.

Similarly, in *American Medical Association v. Federal Trade Commission,* 1980-2 Trade Cas. ¶ 63,569 (2d Cir. 1980), the Court of Appeals specifically stated that a Commission order propriety the AMA from in any way rendering advice about the propriety of the consideration offered for physician's fees "is so broad as to impinge upon valid activity such as professional peer review of the fee practices of physicians." 1980-2 Trade Cas. ¶ 65,569 at p. 77,030. Accordingly, the Federal Trade Commission final order was modified to expressly allow peer review of physicians' fees.

There have also been consent decrees suggesting that peer review of professional fees can be conducted lawfully. Thus, in *United States v. Illinois Podiatry Society,* 1977-2 Trade Cas. ¶ 61,767 (N.D. Ill. 1977), the parties agreed that the podiatry association could not determine maximum fees on the basis of a "relative value guide," but

[4] This Advisory Opinion, like all those issued by the Commission, is limited to the proposed conduct described in the petition being considered. It does not, or course, constitute approval for the specific operations of any particular peer review program that may be or become the subject of litigation before the Commission or any court.

did allow podiatrists to advise third-parties about the propriety of fees upon their own professional experience as podiatrists. In another related instance, the Department of Justice granted clearance to a proposal by the Maryland State Bar Association to collect statistical information, including fees for typical services. *See* Trade Reg. Rep. (CCH) No. 221 at p. 6 (March 29, 1976).

Although it is clearly unlawful for competitors to agree in any fashion to fix prices, *see, e.g., United States v. Socony-Vacuum Oil Co., Inc.,* 310 U.S. 150 (1940), the fee peer review, clearly, does not rise to the level of fee fixing because it is after the fact. In addition, it is considered procompetitive to make information available in order that markets will operate more rationally. In the instance of professional peer review, patients, and particularly third-party providers, may find it procompetitive and beneficial from a standpoint of cost containment to seek the guidance of dentists in determining whether particular fees are excessive. So long as the third-party is not coerced, directly or indirectly, into seeking this review, the effect should not be anti-competitive. This is particularly true in the area of the professions, since the competitive considerations may be somewhat different than those involved in a typical commercial field. *See, e.g., Goldfarb v. Virginia State Bar,* 421 U.S. 773, 788-89, n.17 (1975). Among those competitive considerations are the needs of third parties to seek advice from professionals regarding particular fees.

Based upon a review of the language in *Bartholomew* and *AMA,* it appears that there is little doubt that a properly structured peer review process is lawful. However, out of an abundance of caution, we wish to present a peer review concept to the Commission for its guidance before IDA takes any steps to effectuate peer review of fees. We bring this matter to the Commission because we are well aware of the FTC efforts to aid the containment of costs in the health care field.

Basically, IDA proposes to handle peer review of fees through a free standing committee which would only be involved in fee review. IDA has another mechanism for quality review. This existing council, which does not review fees, undertakes peer review to determine the appropriateness of care and the quality of treatment.

As presently perceived, the IDA peer review committee would have a ten member group that would be composed of one member from each of ten geographically determined district (local) societies.

Under existing procedure regarding quality of care, the chairman of the local peer review committee appoints a panel of not fewer than three dentists who hear all relevant evidence from both the complainant and the dentist. If necessary, the dentists also will conduct a clinical examination, and if a question of specialty is involved, ask a

specialist to consult with them. After reviewing all of the evidence and performing the clinical review, the committee issues written findings that are transmitted to the IDA Council on Dental Care Programs. The peer review committee would follow a similar procedure.

It would be IDA's intention to ask the dentist and the patient to agree prior to the Peer Review to be bound by the Council's determination, although some consideration has been given to the notion that the committee may state its determination and then let the third party make an independent decision about how much of the claim it wishes to honor.

As IDA envisions it, the following would be reviewed in the fee area:

1. The committee would determine whether the dentist in question has charged that dentist's usual fee. In such instances, the dentist would need to submit to an office audit, so that it would be possible for the committee to determine whether the fee is the same fee charged other patients for the same procedure;
2. The committee would also determine whether the fee is "reasonable" because of any special circumstances involved in the case.

The committee would expressly not determine whether the fee is "customary" for that community and would compile no statistics regarding customary fees or in any other way seek to determine whether the fee is customary. The dentists on the committee would, however, seek to determine what is reasonable in light of all circumstances, including their own professional experience as dentists.

Although the decision in *Arizona v. Maricopa County Medical Society,* 1980-1 Trade Cas. ¶ 63,239 (9th Cir. 1980), *pet. for cert. granted* (March 11, 1981), in which the Ninth Circuit Court of Appeals refused to find the imposition of maximum fees by a group of physicians unlawful *per se,* supports IDA's position, it is by no means necessary to reach that issue to approve the IDA plan. *Maricopa County* involved an agreement by physicians to limit fees, something which comes very close to an agreement regarding fees. On the other hand, in the IDA plan, dentists will merely provide information when the reasonableness or excessiveness of fees are placed in issue.

This whole topic of cost containment of professional fees is not only in the public interest but is also extremely important today.

A state dental association as public spirited as the Iowa State Dental Association should be encouraged by government to undertake a fee peer review. I enclose two typewritten pages prepared by the IDA describing this concept of peer review.

Because of the importance of this topic to all of dentistry we would appreciate your very prompt attention.

I would be happy to supply any further information desired by the Commission and to discuss this proposal with Commission personnel.

Respectfully submitted

/s/ Peter M. Sfikas

PEER REVIEW

I. INTRODUCTORY COMMENTS:

Peer review is accomplished almost daily in each dental office albeit in an unconscious fashion. We all judge our diagnosis, treatment plans and work, and we also judge the diagnosis, treatment plan and work of those who have previously cared for our patients.

Basically, only those with something to hide should fear peer review. Many others fear the process because it is not understood. Review can be successful only when dentists understand the process and are willing to cooperate and respect review. We need to realize that review frequently is for the dentist's protection and for the clarification of points between parties. The Peer Review Committees must demonstrate to all concerned that their actions are just and creditable, not white-washing or excuse making.

The system can be successful only if all involved realize its potentials and are willing to accept the review idea as an essential part of business dealings. The review organization must be fair to the patient, the dentist, the third party and the dental profession.

If communication gaps exist, peer review will not realize its full potential. We must explain principles and ideas to one another. Open communication will establish an easy working arrangement with all involved and let the peer review committees function as such, and not as dental consultants, interpreters of contracts or fee negotiators.

The composition of the District Peer Review Committee should be such that the majority of the members are active general practitioners with several years of experience. The members must be respected for their judgement and integrity, and must be convinced of the actual worth of peer review. These persons should be even tempered and level headed, for some review situations will provide rather strong emotional stimuli. The ability to make a fair judgement, despite personalities, is all-important.

STATEMENT REGARDING PEER REVIEW
COMMITTEES AND FEE REVIEWS

In the event the complaint being investigated involves a complaint regarding the fee charged by the dentist, the committee may evaluate the dentist's usual fee and the reasonableness of the fee.

In evaluation of a dentist's usual fee, much will depend of the willingness of the dentist to allow the committee to conduct an in-office audit. The committee must be able

to compare the questioned fee against fees the dentist charges other patients for the same procedures, everything else being relatively equal. The purpose of such review will be to make a determination that the challenged fee is or is not the dentist's usual fee for the same procedure.

The committee may review the reasonableness of a fee to determine that the circumstances of a particular case are such as to warrant the dentist charging more than his usual fee. The purpose of the committee review is not to determine what the fee should be, but only to determine whether the fee is reasonable because of special circumstances, to charge a fee different than the usual fee charged by the dentist.

The committee should not make any determination whether the fee is the customary fee charged in the community. The committee should not collect any fee data or attempt in any way to determine a composite of fees charged in the community in order to determine whether or not a particular fee is in keeping with the customary fees charged in the community. There should be no attempt to investigate what fees are charged for a particular procedure in the community by other dentists.

Second Letter of Request

March 4, 1982

Dear Chairman Miller:

On March 17, 1981, I wrote to the Commission on behalf of the Iowa Dental Association requesting an advisory opinion concerning an Iowa Dental Association proposal for providing peer review of dental fees that patients or insurance carriers question as being excessive. This request for an advisory opinion was made out of an excess of caution because of positions the FTC had taken with reference to the dental profession.

Since this request will aid the effort to contain health care costs, I anticipated that it would be processed quickly by the Commission. To my dismay, I find that the one year anniversary of my request is approaching without any assurance that my request will even have advanced from the Bureau of Competition to the Commission itself.

The advisory opinion procedure is a highly desirable one for clients, such as the Iowa Dental Association, who wish to avoid any possibility that their activities might be deemed improper by the Commission. Moreover, the procedure is far more satisfactory than an adjudicatory procedure for determining, in an economical, timely and cooperative fashion, unique questions of law and policy. However, all of the theoretical benefits of the advisory opinion procedure are negated when it takes over a year to receive a response from the Commission. Both our client and the interested third parties have been completely immobilized by this delay. It is, or course, the ultimate consumer—the patient—that is without this significant effort at cost containment.

Accordingly, I respectfully request that the Commission make every effort to expedite its final decision on the Iowa Dental Association's request for an advisory opinion.

Respectfully,

/s/ Peter M. Sfikas

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